ACBA BENCH-BAR CONFERENCE 2023

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BLOCKCHAIN IN BANKRUPTCY: DISCUSSING CRYPTOCURRENCIES' TREATMENT IN IN BANKRUPTCY PROCEEDINGS AND ETHICAL CONSIDERATIONS FOR PRACTITIONERS

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TABLE OF CONTENTS

14.	"Cryptocurrency 2023 Legislation Summary" National Conference of State Legislatures, https://www.ncsl.org/financial-services/cryptocurrency-2023-legislation. Last updated: March 26, 2023.
15.	White III, Clifford J. "Principles to Guide USTP Enforcement of the Duty of Professionals to Disclose Connections to a Bankruptcy Case Under 11 U.S.C. §§ 327 and 1103 and Fed. R. Bankr. P. 2014." Executive Office for United States Trustees (Dec. 4, 2019)
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18.	*In re Three Arrows Cap., Ltd.*, 647 B.R 440 (Bankr. S.D.N.Y. Dec. 29, 2022)
19.	*In re BlockFi Inc.*, Case No. 22-19361 (Bank. D. N.J.)
20.	*In re Cred, Inc.*, Case No. 20-12836 (Bankr. D. Del.) Doc. No. 605
21.	*In re Celsius Network LLC*, Case No. 22-10964 (Bankr. S.D.N.Y.) Doc. No. 1956
22.	*In re FTX Trading Ltd.*, Case No. 22-11068 (Bankr. D. Del.) Doc. No. 24
23.	*Genesis Global HoldCo, LLC, et al.*, Case No. 23-10063 (Bankr. S.D.N.Y.) Doc. No. 2
24.	*In re Core Scientific Inc., et al.*, Case No. 22-90341 (Bankr. S.D.T.X.) Doc. No. 1
25.	*In re Squirrels Rsch. Labs, LLC*, No. 21-61491, 2022 WL 1310173 (Bankr. N.D. Ohio Apr. 29, 2022)
26.	*In re Giga Watt, Inc.*, Case No. 18-03197 (Bankr. E.D. Wash.) WL 1587723
27.	*In re Hao*, 644 B.R. 339 (Bankr. E.D. Va. 2022)
28.	*In re Reichmeier*, Case No. 18-21427 (Bankr. D. Kan.) 2020 WL 1908328
29.	*In re Hortman*, No. AP 20-02021, 2022 WL 272146, at *7 (Bankr. D. Utah Jan. 27, 2022)
30.	*In re Sours,* Case No. 21-31943 (Bankr. D. Or.) 2022 WL 4652022
31.	*Vyas v. Polsinelli PC*, Case No. 8:22-CV-71-VMC-CPT (M.D. Fla.) 2022 WL 156805
32.	*In re Tezos Sec. Litig.*, Case No. 17-CV-06779-RS, (N.D. Cal.) 2018 WL 4293341
33.	*Balestra v. Cloud With Me Ltd.*, Case No. 2:18-CV-00804 (W.D. Pa.) 2020 WL 4368153
34.	*Fabian v. LeMahieu*, Case No. 19-CV-00054, (N.D. Cal.) 2020 WL 3402800
35.	*Hunichen v. Atonomi LLC*, Case No. 19-0615 (W.D. Wash.) 2021 WL 5858811
36.	*Atwal v. NortonLifeLock, Inc.*, Case No. 20-CV-449S (W.D.N.Y.) 2022 WL 327471
37.	*Arberman v. PNC Bank, Nat'l Ass'n*, Case No. 22-80983 (S.D. Fla.) 2022 WL 18402402
38.	*Diamond Fortress Techs., Inc. v. EverID, Inc.*, C.A. No. N21C-05-048 PRW (Del. Super. Ct. 2022)
39.	*BDI Cap., LLC v. Bulbul Invs. LLC*, 446 F. Supp. 3d 1127, 1140–41 (N.D. Ga. 2020)
40.	*Coinbase Inc. v. Bielski*, 214 L. Ed. 2d 298, 143 S. Ct. 521 (2022) 2022 WL 3099846
41.	*In re SVB Financial Group*, Case No. 23-10367 (Bankr. S.D.N.Y.)

TAB 1

Pennsylvania Rules of Professional Conduct

The
DISCIPLINARY BOARD
of the Supreme Court of Pennsylvania

PENNSYLVANIA
RULES OF PROFESSIONAL CONDUCT

INCLUDES AMENDMENTS THROUGH APRIL 11, 2023

FOR THE MOST UP TO DATE VERSION OF THE RULES OF PROFESSIONAL CONDUCT, SCAN THE ABOVE QR CODE OR VISIT OUR WEBSITE AT WWW.PADISCIPLINARYBOARD.ORG

April 11, 2023

PENNSYLVANIA RULES OF PROFESSIONAL CONDUCT

Adopted by Order of the Supreme Court of Pennsylvania dated October 16, 1987 effective April 1, 1988

Text contains recent revisions & amendments which became effective January 1, 2005, January 6, 2005, March 17, 2005, April 23, 2005, July 1, 2006, September 20, 2008, April 3, 2009, May 2, 2009, April 9, 2012, April 18, 2012, June 16, 2012, July 4, 2012, November 21, 2013, February 9, 2015 February 28, 2015, October 23, 2016, November 25, 2016, January 4, 2017, July 1, 2018, September 28, 2018, February 7, 2019, May 18, 2019, September 14, 2019, November 25, 2020, December 8, 2020, February 24, 2021, August 25, 2021 and April 11, 2023.

TABLE OF CONTENTS

PENNSYLVANIA RULES OF PROFESSIONAL CONDUCT

PREAMBLE: A Lawyer's Responsibilities

[1] A lawyer, as a member of the legal profession, is a representative of clients, an officer of the legal system and a public citizen having a special responsibility for the quality of justice.

[2] As a representative of clients, a lawyer performs various functions. As advisor, a lawyer provides a client with an informed understanding of the client's legal rights and obligations and explains their practical implications. As advocate, a lawyer zealously asserts the client's position under the rules of the adversary system. As negotiator, a lawyer seeks a result advantageous to the client but consistent with requirements of honest dealings with others. As an evaluator, a lawyer acts by examining a client's legal affairs and reporting about them to the client or to others.

[3] In addition to these representational functions, a lawyer may serve as a third-party neutral, a nonrepresentational role helping the parties to resolve a dispute or other matter. Some of these Rules apply directly to lawyers who are or have served as third-party neutrals. See, e.g., Rules 1.12 and 2.4. In addition, there are Rules that apply to lawyers who are not active in the practice of law or to practicing lawyers even when they are acting in a nonprofessional capacity. For example, a lawyer who commits fraud in the conduct of a business is subject to discipline for engaging in conduct involving dishonesty, fraud, deceit or misrepresentation. See Rule 8.4.

[4] In all professional functions a lawyer should be competent, prompt and diligent. A lawyer should maintain communication with a client concerning the representation. A lawyer should keep in confidence information relating to representation of a client except so far as disclosure is required or permitted by the Rules of Professional Conduct or other law.

[5] A lawyer's conduct should conform to the requirements of the law, both in professional service to clients and in the lawyer's business and personal affairs. A lawyer should use the law's procedures only for legitimate purposes and not to harass or intimidate others. A lawyer should demonstrate respect for the legal system and for those who serve it, including judges, other lawyers and public officials. While it is a lawyer's duty, when necessary, to challenge the rectitude of official action, it is also a lawyer's duty to uphold legal process.

[6] As a public citizen, a lawyer should seek improvement of the law, access to the legal system, the administration of justice and the quality of service rendered by the legal profession. As a member of a learned profession, a lawyer should cultivate knowledge of the law beyond its use for clients, employ that knowledge in reform of the law and work to strengthen legal education. In addition, a lawyer should further the public's understanding of and confidence in the rule of law and the justice system because legal institutions in a constitutional democracy depend on popular participation and support to maintain their authority. A lawyer should be mindful of deficiencies in the administration of justice and of the fact that the poor, and sometimes persons who are not poor, cannot afford adequate legal assistance. Therefore, all lawyers should devote professional time and resources and use civic influence to ensure equal access to our system of justice for all those who because of economic or social barriers cannot afford or secure adequate legal counsel. A lawyer should aid the legal profession in pursuing these objectives and should help the bar regulate itself in the public interest.

[7] Many of a lawyer's professional responsibilities are prescribed in the Rules of Professional Conduct, as well as substantive and procedural law. However, a lawyer is also guided by personal conscience and the approbation of professional peers. A lawyer should strive to attain the highest level of skill, to improve the law and the legal profession and to exemplify the legal profession's ideals of public service.

[8] A lawyer's responsibilities as a representative of clients, an officer of the legal system and a public citizen are usually harmonious. Thus, when an opposing party is well represented, a lawyer can be a zealous advocate on behalf of a client and at the same time assume that justice is being done. So also, a lawyer can be sure that preserving client confidences ordinarily serves the public interest because people are more likely to seek legal advice, and thereby heed their legal obligations, when they know their communications will be private.

[9] In the nature of law practice, however, conflicting responsibilities are encountered. Virtually all difficult ethical problems arise from conflict between a lawyer's responsibilities to clients, to the legal system and to the lawyer's own interest in remaining an ethical person while earning a satisfactory living. The Rules of Professional Conduct often prescribe terms for resolving such conflicts. Within the framework of these Rules, however, many difficult issues of professional discretion can arise. Such issues must be resolved through the exercise of sensitive professional and moral judgment guided by the basic principles underlying the Rules. These principles include the lawyer's obligation zealously to protect and pursue a client's legitimate interests, within the bounds of the law, while maintaining a professional, courteous and civil attitude toward all persons involved in the legal system.

[10] The legal profession is largely self-governing. Although other professions also have been granted powers of self-government, the legal profession is unique in this respect because of the close relationship between the profession and the processes of government and law enforcement. This connection is manifested in the fact that ultimate authority over the legal profession is vested largely in the courts.

[11] To the extent that lawyers meet the obligations of their professional calling, the occasion for government regulation is obviated. Self-regulation also helps maintain the legal profession's independence from government domination. An independent legal profession is an important force in preserving government under law, for abuse of legal authority is more readily challenged by a profession whose members are not dependent on government for the right to practice.

[12] The legal profession's relative autonomy carries with it special responsibilities of self-government. The profession has a responsibility to assure that its regulations are conceived in the public interest and not in furtherance of parochial or self-interested concerns of the bar. Every lawyer is responsible for observance of the Rules of Professional Conduct. A lawyer should also aid in securing their observance by other lawyers. Neglect of these responsibilities compromises the independence of the profession and the public interest which it serves.

[13] Lawyers play a vital role in the preservation of society. The fulfillment of this role requires an understanding by lawyers of their relationship to our legal system. The Rules of Professional Conduct, when properly applied, serve to define that relationship.

SCOPE

[14] The Rules of Professional Conduct are rules of reason. They should be interpreted with reference to the purposes of legal representation and of the law itself. Some of the Rules are imperatives, cast in the terms "shall" or "shall not." These define proper conduct for purposes of professional discipline. Others, generally cast in the term "may" or "should," are permissive and define areas under the Rules in which the lawyer has discretion to exercise professional judgment. No disciplinary action should be taken when the lawyer chooses not to act or acts within the bounds of such discretion. Other Rules define the nature of relationships between the lawyer and others. The Rules are thus partly obligatory and disciplinary and partly constitutive and descriptive in that they define a lawyer's professional role. Many of the Comments use the term "should." Comments do not add obligations to the Rules but provide guidance for practicing in compliance with the Rules.

[15] The Rules presuppose a larger legal context shaping the lawyer's role. That context includes court rules and statutes relating to matters of licensure, laws defining specific obligations of lawyers and substantive and procedural law in general. The Comments are sometimes used to alert lawyers to their responsibilities under such other law. Compliance with the Rules, as with all law in an open society, depends primarily upon understanding and voluntary compliance, secondarily upon reinforcement by peer and public opinion and finally, when necessary, upon enforcement through disciplinary proceedings. The Rules do not, however, exhaust the moral and ethical considerations that should inform a lawyer, for no worthwhile human activity can be completely defined by legal rules. The Rules simply provide a framework for the ethical practice of law.

[16] Furthermore, for purposes of determining the lawyer's authority and responsibility, principles of substantive law external to these Rules determine whether a client-lawyer relationship exists. Most of the duties flowing from the client-lawyer relationship attach only after the client has requested the lawyer to render legal services and the lawyer has agreed to do so. But there are some duties, such as that of confidentiality under Rule 1.6, that attach when the lawyer agrees to consider whether a client-lawyer relationship shall be

established. See Rule 1.18. Whether a client-lawyer relationship exists for any specific purpose can depend on the circumstances and may be a question of fact.

[17] Under various legal provisions, including constitutional, statutory and common law, the responsibilities of government lawyers may include authority concerning legal matters that ordinarily reposes in the client in private client-lawyer relationships. For example, a lawyer for a government agency may have authority on behalf of the government to decide upon settlement or whether to appeal from an adverse judgment. Such authority in various respects is generally vested in the attorney general and the state's attorney in state government, and their federal counterparts, and the same may be true of other government law officers. Also, lawyers under the supervision of these officers may be authorized to represent several government agencies in intragovernmental legal controversies in circumstances where a private lawyer could not represent multiple private clients. These Rules do not abrogate any such authority.

[18] Failure to comply with an obligation or prohibition imposed by a Rule is a basis for invoking the disciplinary process. The Rules presuppose that disciplinary assessment of a lawyer's conduct will be made on the basis of the facts and circumstances as they existed at the time of the conduct in question and in recognition of the fact that a lawyer often has to act upon uncertain or incomplete evidence of the situation. Moreover, the Rules presuppose that whether or not discipline should be imposed for a violation, and the severity of a sanction, depend on all the circumstances, such as the willfulness and seriousness of the violation, extenuating factors and whether there have been previous violations.

[19] Violation of a Rule should not itself give rise to a cause of action against a lawyer nor should it create any presumption in such a case that a legal duty has been breached. In addition, violation of a Rule does not necessarily warrant any other nondisciplinary remedy, such as disqualification of a lawyer in pending litigation. The Rules are designed to provide guidance to lawyers and to provide a structure for regulating conduct through disciplinary agencies. They are not designed to be a basis for civil liability. Furthermore, the purpose of the Rules can be subverted when they are invoked by opposing parties as procedural weapons. The fact that a Rule is a just basis for a lawyer's self-assessment, or for sanctioning a lawyer under the administration of a disciplinary authority, does not imply that an antagonist in a collateral proceeding or transaction has standing to seek enforcement of the Rule. Accordingly, nothing in the Rules should be deemed to augment any substantive legal duty of lawyers or the extra disciplinary consequences of violating such a duty.

[20] These Rules were first derived from the Model Rules of Professional Conduct adopted by the American Bar Association in 1983 as amended. Those Rules were subject to thorough review and restatement through the work of the ABA Commission on Evaluation of the Rules of Professional Conduct ("Ethics 2000 Commission"), and have been subject to certain modifications in their adoption in Pennsylvania. The Rules omit some provisions that appear in the ABA Model Rules of Professional Conduct. The omissions should not be interpreted as condoning behavior proscribed by the omitted provision.

[21] The Comment accompanying each Rule explains and illustrates the meaning and purpose of the Rule. The Preamble and this note on Scope provide general orientation. The Comments are intended as guides to interpretation, but the text of each Rule is authoritative.

Rule 1.0 Terminology

(a) "Belief" or "believes" denotes that the person involved actually supposed the fact in question to be true. A person's belief may be inferred from circumstances.

(b) "Confirmed in writing," when used in reference to the informed consent of a person, denotes an informed consent that is given in writing by the person or a writing that a lawyer promptly transmits to the person confirming an oral informed consent. See paragraph (e) for the definition of "informed consent." If it is not feasible to obtain or transmit the writing at the time the person gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter.

(c) "Firm" or "law firm" denotes a lawyer or lawyers in a law partnership, professional corporation, sole proprietorship or other association authorized to practice law; or lawyers employed in a legal services organization or the legal department of a corporation or other organization.

(d) "Fraud" or "fraudulent" denotes conduct that is fraudulent under the substantive or procedural law of the applicable jurisdiction and has a purpose to deceive.

(e) "Informed consent" denotes the consent by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

(f) "Knowingly," "Known," or "Knows" denotes actual knowledge of the fact in question. A person's knowledge may be inferred from circumstances.

(g) "Partner" denotes an equity owner in a law firm, whether in the capacity of a partner in a partnership, a shareholder in a professional corporation, a member in a limited liability company, a beneficiary of a business trust, a member of an association authorized to practice law, or otherwise.

(h) "Reasonable" or "Reasonably" when used in relation to conduct by a lawyer denotes the conduct of a reasonably prudent and competent lawyer.

(i) "Reasonable belief" or "Reasonably believes" when used in reference to a lawyer denotes that the lawyer believes the matter in question and that the circumstances are such that the belief is reasonable.

(j) "Reasonably should know" when used in reference to a lawyer denotes that a lawyer of reasonable prudence and competence would ascertain the matter in question.

(k) "Screened" denotes the isolation of a lawyer from any participation in a matter through the timely imposition of procedures within a firm that are reasonably adequate under the circumstances to protect information that the isolated lawyer is obligated to protect under these Rules or other law.

(l) "Substantial" when used in reference to degree or extent denotes a material matter of clear and weighty importance.

(m) "Tribunal" denotes a court, an arbitrator in a binding arbitration proceeding or a legislative body, administrative agency or other body acting in an adjudicative capacity. A legislative body, administrative agency or other body acts in an adjudicative capacity when a neutral official, after the presentation of evidence or legal argument by a party or parties, will render a binding legal judgment directly affecting a party's interests in a particular matter.

(n) "Writing" or "written" denotes a tangible or electronic record of a communication or representation, including handwriting, typewriting, printing, photostatting, photography, audio or video recording, and electronic communications. A "signed" writing includes an electronic sound, symbol or process attached to or logically associated with a writing and executed or adopted by a person with the intent to sign the writing.

Comment:

Confirmed in Writing

[1] If it is not feasible to obtain or transmit a written confirmation at the time the client gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter. If a lawyer has obtained a client's informed consent, the lawyer may act in reliance on that agreement of consent so long as it is confirmed in writing within a reasonable time thereafter.

Firm

[2] The terms of any formal agreement between associated lawyers are relevant in determining whether they are a firm, as is the fact that they have mutual access to information concerning the clients they serve. Furthermore, it is relevant in doubtful cases to consider the underlying purpose of the Rule that is involved. A group of lawyers could be regarded as a firm for purposes of a rule that the same lawyer should not represent opposing parties in litigation, e.g., Rules 1.7(a), 1.10(a), while it might not be so regarded for purposes of a rule that information acquired by one lawyer is attributed to another, e.g., Rule 1.10(b).

[3] With respect to the law department of an organization, including the government, there is ordinarily no question that the members of the department constitute a firm within the meaning of the Rules of Professional Conduct. There can be uncertainty, however, as to the identity of the client. For example, it may not be clear whether the law department of a corporation represents a subsidiary or an affiliated corporation, as well as the corporation by which the members of the department are directly employed. A similar question can arise concerning an unincorporated association and its local affiliates.

[4] Similar questions can also arise with respect to lawyers in legal aid and legal services organizations. Depending upon the structure of the organization, the entire organization or different components of it may constitute a firm or firms for purposes of these Rules.

Fraud

[5] When used in these Rules, the terms "fraud" and "fraudulent" refer to conduct that is characterized as such under the substantive or procedural law of the applicable jurisdiction and has a purpose to deceive. This does not include merely negligent misrepresentation or negligent failure to apprise another of relevant information. For purposes of these Rules, it is not necessary that anyone has suffered damages or relied on the misrepresentation or failure to inform.

Informed Consent

[6] Many of the Rules of Professional Conduct require the lawyer to obtain the informed consent of a client or other person (e.g., a former client or, under certain circumstances, a prospective client) before accepting or continuing representation or pursuing a course of conduct. See, e.g., Rules 1.2(c), 1.6(a), 1.7(b), 1.8(a)(3), (b), (f) and (g), 1.9(a) and (b), 1.10(d), 1.11(a)(2) and (d)(2)(i), 1.12(a) and 1.18(d)(1). The communication necessary to obtain such consent will vary according to the Rule involved and the circumstances giving rise to the need to obtain informed consent. The lawyer must make reasonable efforts to ensure that the client or other person possesses information reasonably adequate to make an informed decision. Ordinarily, this will require communication that includes a disclosure of the facts and circumstances giving rise to the situation, any explanation reasonably necessary to inform the client or other person of the material advantages and disadvantages of the proposed course of conduct and a discussion of the client's or other person's options and alternatives. In some circumstances it may be appropriate for a lawyer to advise a client or other person to seek the advice of other counsel. A lawyer need not inform a client or other person of facts or implications already known to the client or other person; nevertheless, a lawyer who does not personally inform the client or other person assumes the risk that the client or other person is inadequately informed and the consent is invalid. In determining whether the information and explanation provided are reasonably adequate, relevant factors include whether the client or other person is experienced in legal matters generally and in making decisions of the type involved, and whether the client or other person is independently represented by other counsel in giving the consent. Normally, such persons need less information and explanation than others, and generally a client or other person who is independently represented by other counsel in giving the consent should be assumed to have given informed consent.

[7] Obtaining informed consent will usually require an affirmative response by the client or other person. In general, a lawyer may not assume consent from a client's or other person's silence. Consent may be inferred, however, from the conduct of a client or other person who has reasonably adequate information about the matter. Rule 1.8(a) requires that a client's consent be obtained in a writing signed by the client. For a definition of "signed," see paragraph (n). The term informed consent in Rule 1.0 and the guidance provided in the Comment should be understood in the context of legal ethics and is not intended to incorporate jurisprudence of medical malpractice law.

Screened

[8] This definition applies to situations where screening of a personally disqualified lawyer is permitted to remove imputation of a conflict of interest under Rules 1.10, 1.11, 1.12, or 1.18.

[9] The purpose of screening is to assure the affected parties that confidential information known by the personally disqualified lawyer remains protected. The personally disqualified lawyer should acknowledge the obligation not to communicate with any of the other lawyers in the firm with respect to the matter. Similarly, other lawyers in the firm who are working on the matter should be informed that the screening is in place and that they may not communicate with the personally disqualified lawyer with respect to the matter. Additional screening measures that are appropriate for the particular matter will depend on the circumstances.

To implement, reinforce and remind all affected lawyers of the presence of the screening, it may be appropriate for the firm to undertake such procedures as a written undertaking by the screened lawyer to avoid any communication with other firm personnel and any contact with any firm files or other information, including information in electronic form, relating to the matter, written notice and instructions to all other firm personnel forbidding any communication with the screened lawyer relating to the matter, denial of access by the screened lawyer to firm files or other information, including information in electronic form, relating to the matter, and periodic reminders of the screen to the screened lawyer and all other firm personnel.

[10] In order to be effective, screening measures must be implemented as soon as practical after a lawyer or law firm knows or reasonably should know that there is a need for screening.

Rule 1.1 Competence

A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

Comment:

Legal Knowledge and Skill

[1] In determining whether a lawyer employs the requisite knowledge and skill in a particular matter, relevant factors include the relative complexity and specialized nature of the matter, the lawyer's general experience, the lawyer's training and experience in the field in question, the preparation and study the lawyer is able to give the matter and whether it is feasible to refer the matter to, or associate or consult with, a lawyer of established competence in the field in question. In many instances, the required proficiency is that of a general practitioner. Expertise in a particular field of law may be required in some circumstances.

[2] A lawyer need not necessarily have special training or prior experience to handle legal problems of a type with which the lawyer is unfamiliar. Some important legal skills, such as the analysis of precedent, the evaluation of evidence and legal drafting, are required in all legal problems. Perhaps the most fundamental legal skill consists of determining what kind of legal problems a situation may involve, a skill that necessarily transcends any particular specialized knowledge. A lawyer can provide adequate representation in a wholly novel field through necessary study. Competent representation can also be provided through the association of a lawyer of established competence in the field in question.

[3] In an emergency a lawyer may give advice or assistance in a matter in which the lawyer does not have the skill ordinarily required where referral to or consultation or association with another lawyer would be impracticable. Even in an emergency, however, assistance should be limited to that reasonably necessary in the circumstances, for ill considered action under emergency conditions can jeopardize the client's interest.

[4] A lawyer may accept representation where the requisite level of competence can be achieved by reasonable preparation. This applies as well to a lawyer who is appointed as counsel for an unrepresented person. See also Rule 6.2.

Thoroughness and Preparation

[5] Competent handling of particular matter includes inquiry into and analysis of the factual and legal elements of the problem, and use of methods and procedures meeting the standards of competent practitioners. It also includes adequate preparation. The required attention and preparation are determined in part by what is at stake; major litigation and complex transactions ordinarily require more extensive treatment than matters of lesser complexity and consequence. An agreement between the lawyer and the client regarding the scope of the representation may limit the matters for which the lawyer is responsible. See Rule 1.2(c).

Retaining or Contracting With Other Lawyers

[6] Before a lawyer retains or contracts with other lawyers outside the lawyer's own firm to provide or assist in the provision of legal services to a client, the lawyer must reasonably believe that the other lawyers' services will contribute to the competent and ethical representation of the client. See also Rules 1.2, 1.4, 1.6, and 5.5(a). The reasonableness of the decision to retain or contract with other lawyers outside the lawyer's

own firm will depend upon the circumstances, including the education, experience and reputation of the nonfirm lawyers; the nature of the services assigned to the nonfirm lawyers; and the legal protections, professional conduct rules, and ethical environments of the jurisdictions in which the services will be performed, particularly relating to confidential information.

[7] When lawyers from more than one law firm are providing legal services to the client on a particular matter, the lawyers ordinarily should consult with each other and the client about the scope of their respective representations and the allocation of responsibility among them. See Rule 1.2. When making allocations of responsibility in a matter pending before a tribunal, lawyers and parties may have additional obligations that are a matter of law beyond the scope of these Rules.

Maintaining Competence

[8] To maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology, engage in continuing study and education and comply with all continuing legal education requirements to which the lawyer is subject. To provide competent representation, a lawyer should be familiar with policies of the courts in which the lawyer practices, which include the Case Records Public Access Policy of the Unified Judicial System of Pennsylvania.

Rule 1.2 Scope of Representation and Allocation of Authority Between Client and Lawyer

(a) Subject to paragraphs (c) and (d), a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation. A lawyer shall abide by a client's decision whether to settle a matter. In a criminal case, the lawyer shall abide by the client's decision, after consultation with the lawyer, as to a plea to be entered, whether to waive jury trial and whether the client will testify.

(b) A lawyer's representation of a client, including representation by appointment, does not constitute an endorsement of the client's political, economic, social or moral views or activities.

(c) A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.

(d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

(e) A lawyer may counsel or assist a client regarding conduct expressly permitted by Pennsylvania law, provided that the lawyer counsels the client about the legal consequences, under other applicable law, of the client’s proposed course of conduct.

Comment:

Allocation of Authority between Client and Lawyer

[1] Paragraph (a) confers upon the client the ultimate authority to determine the purposes to be served by legal representation, within the limits imposed by law and the lawyer's professional obligations. The decisions specified in paragraph (a), such as whether to settle a civil matter, must also be made by the client. See Rule 1.4(a)(1) for the lawyer's duty to communicate with the client about such decisions. With respect to the means by which the client's objectives are to be pursued, the lawyer shall consult with the client as required by Rule 1.4(a)(2) and may take such action as is impliedly authorized to carry out the representation.

[2] On occasion, however, a lawyer and a client may disagree about the means to be used to accomplish the client's objectives. Clients normally defer to the special knowledge and skill of their lawyer with respect to the means to be used to accomplish their objectives, particularly with respect to technical, legal and tactical matters. Conversely, lawyers usually defer to the client regarding such questions as the expense

to be incurred and concern for third persons who might be adversely affected. Because of the varied nature of the matters about which a lawyer and client might disagree and because the actions in question may implicate the interests of a tribunal or other persons, this Rule does not prescribe how such disagreements are to be resolved. Other law, however, may be applicable and should be consulted by the lawyer. The lawyer should also consult with the client and seek a mutually acceptable resolution of the disagreement. If such efforts are unavailing and the lawyer has a fundamental disagreement with the client, the lawyer may withdraw from the representation. See Rule 1.16(b)(4). Conversely, the client may resolve the disagreement by discharging the lawyer. See Rule 1.16(a)(3).

[3] At the outset of a representation, the client may authorize the lawyer to take specific action on the client's behalf without further consultation. Absent a material change in circumstances and subject to Rule 1.4, a lawyer may rely on such an advance authorization. The client may, however, revoke such authority at any time.

[4] In a case in which the client appears to be suffering diminished capacity, the lawyer's duty to abide by the client's decisions is to be guided by reference to Rule 1.14.

Independence from Client's Views or Activities

[5] Legal representation should not be denied to people who are unable to afford legal services, or whose cause is controversial or the subject of popular disapproval. By the same token, representing a client does not constitute approval of the client's views or activities.

Agreements Limiting Scope of Representation

[6] The scope of services to be provided by a lawyer may be limited by agreement with the client or by the terms under which the lawyer's services are made available to the client. When a lawyer has been retained by an insurer to represent an insured, for example, the representation may be limited to matters related to the insurance coverage. A limited representation may be appropriate because the client has limited objectives for the representation. In addition, the terms upon which representation is undertaken may exclude specific means that might otherwise be used to accomplish the client's objectives. Such limitations may exclude actions that the client thinks are too costly or that the lawyer regards as repugnant or imprudent.

[7] Although this Rule affords the lawyer and client substantial latitude to limit the representation, the limitation must be reasonable under the circumstances. If, for example, a client's objective is limited to securing general information about the law the client needs in order to handle a common and typically uncomplicated legal problem, the lawyer and client may agree that the lawyer's services will be limited to a brief telephone consultation. Such a limitation, however, would not be reasonable if the time allotted was not sufficient to yield advice upon which the client could rely. Although an agreement for a limited representation does not exempt a lawyer from the duty to provide competent representation, the limitation is a factor to be considered when determining the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation. See Rule 1.1.

[8] All agreements concerning a lawyer's representation of a client must accord with the Rules of Professional Conduct and other law. See, e.g., Rules 1.1, 1.8, and 5.6.

Criminal, Fraudulent and Prohibited Transactions

[9] Paragraph (d) prohibits a lawyer from knowingly counseling or assisting a client to commit a crime or fraud. This prohibition, however, does not preclude the lawyer from giving an honest opinion about the actual consequences that appear likely to result from a client's conduct. Nor does the fact that a client uses advice in a course of action that is criminal or fraudulent of itself make a lawyer a party to the course of action. There is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity.

[10] When the client's course of action has already begun and is continuing, the lawyer's responsibility is especially delicate. The lawyer is required to avoid assisting the client, for example, by drafting or delivering documents that the lawyer knows are fraudulent or by suggesting how the wrongdoing might be concealed. A lawyer may not continue assisting a client in conduct that the lawyer originally supposed was legally proper but then discovers is criminal or fraudulent. The lawyer must, therefore, withdraw from the representation of the client in the matter. See Rule 1.16(a). In some cases, withdrawal alone might be

insufficient. It may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm any opinion, document, affirmation or the like. See Rule 4.1.

[11] Where the client is a fiduciary, the lawyer may be charged with special obligations in dealings with a beneficiary.

[12] Paragraph (d) applies whether or not the defrauded party is a party to the transaction. Hence, a lawyer must not participate in a transaction to effectuate criminal or fraudulent avoidance of tax liability. Paragraph (d) does not preclude undertaking a criminal defense incident to a general retainer for legal services to a lawful enterprise. The last clause of paragraph (d) recognizes that determining the validity or interpretation of a statute or regulation may require a course of action involving disobedience of the statute or regulation or of the interpretation placed upon it by governmental authorities.

[13] If a lawyer comes to know or reasonably should know that a client expects assistance not permitted by the Rules of Professional Conduct or other law or if the lawyer intends to act contrary to the client's instructions, the lawyer must consult with the client regarding the limitations on the lawyer's conduct. See Rule 1.4(a)(5).

Rule 1.3 Diligence

A lawyer shall act with reasonable diligence and promptness in representing a client.

Comment:

[1] A lawyer should pursue a matter on behalf of a client despite opposition, obstruction or personal inconvenience to the lawyer, and take whatever lawful and ethical measures are required to vindicate a client's cause or endeavor. A lawyer must also act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client's behalf. A lawyer is not bound, however, to press for every advantage that might be realized for a client. For example, a lawyer may have authority to exercise professional discretion in determining the means by which a matter should be pursued. See Rule 1.2. The lawyer's duty to act with reasonable diligence does not require the use of offensive tactics or preclude the treating of all persons involved in the legal process with courtesy and respect.

[2] A lawyer's work load must be controlled so that each matter can be handled competently.

[3] Perhaps no professional shortcoming is more widely resented than procrastination. A client's interests often can be adversely affected by the passage of time or the change of conditions; in extreme instances, as when a lawyer overlooks a statute of limitations, the client's legal position may be destroyed. Even when the client's interests are not affected in substance, however, unreasonable delay can cause a client needless anxiety and undermine confidence in the lawyer's trustworthiness. A lawyer's duty to act with reasonable promptness, however, does not preclude the lawyer from agreeing to a reasonable request for a postponement that will not prejudice the lawyer's client.

[4] Unless the relationship is terminated as provided in Rule 1.16, a lawyer should carry through to conclusion all matters undertaken for a client. If a lawyer's employment is limited to a specific matter, the relationship terminates when the matter has been resolved. If a lawyer has served a client over a substantial period in a variety of matters, the client sometimes may assume that the lawyer will continue to serve on a continuing basis unless the lawyer gives notice of withdrawal. Doubt about whether a client-lawyer relationship still exists should be clarified by the lawyer, preferably in writing, so that the client will not mistakenly suppose the lawyer is looking after the client's affairs when the lawyer has ceased to do so. For example, if a lawyer has handled a judicial or administrative proceeding that produced a result adverse to the client and the lawyer and the client have not agreed that the lawyer will handle the matter on appeal, the lawyer must consult with the client about the possibility of appeal before relinquishing responsibility for the matter. See Rule 1.4(a)(2). Whether the lawyer is obligated to prosecute the appeal for the client depends on the scope of the representation the lawyer has agreed to provide to the client. See Rule 1.2.

[5] To prevent neglect of client matters in the event of a sole practitioner's death or disability, the duty of diligence may require that each sole practitioner prepare a plan, in conformity with applicable rules, that designates another competent lawyer to review client files, notify each client of the lawyer's death or disability, and determine whether there is a need for immediate protective action. Cf. Rule 28 of the American

Bar Association Model Rules for Lawyer Disciplinary Enforcement (providing for court appointment of a lawyer to inventory files and take other protective action in absence of a plan providing for another lawyer to protect the interests of the clients of a deceased or disabled lawyer).

Rule 1.4 Communication

(a) A lawyer shall:

(1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required by these Rules;

(2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;

(3) keep the client reasonably informed about the status of the matter;

(4) promptly comply with reasonable requests for information; and

(5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.

(b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

(c) A lawyer in private practice shall inform a new client in writing if the lawyer does not have professional liability insurance of at least $100,000 per occurrence and $300,000 in the aggregate per year, subject to commercially reasonable deductibles, retention or co-insurance, and shall inform existing clients in writing at any time the lawyer's professional liability insurance drops below either of those amounts or the lawyer's professional liability insurance is terminated. A lawyer shall maintain a record of these disclosures for six years after the termination of the representation of a client.

Comment:

[1] Reasonable communication between the lawyer and the client is necessary for the client effectively to participate in the representation.

Communicating with Client

[2] If these Rules require that a particular decision about the representation be made by the client, paragraph (a)(1) requires that the lawyer promptly consult with and secure the client's consent prior to taking action unless prior discussions with the client have resolved what action the client wants the lawyer to take. For example, a lawyer who receives from opposing counsel an offer of settlement in a civil controversy or a proffered plea bargain in a criminal case must promptly inform the client of its substance unless the client has previously indicated that the proposal will be acceptable or unacceptable or has authorized the lawyer to accept or to reject the offer. See Rule 1.2(a).

[3] Paragraph (a)(2) requires the lawyer to reasonably consult with the client about the means to be used to accomplish the client's objectives. In some situations - depending on both the importance of the action under consideration and the feasibility of consulting with the client - this duty will require consultation prior to taking action. In other circumstances, such as during a trial when an immediate decision must be made, the exigency of the situation may require the lawyer to act without prior consultation. In such cases the lawyer must nonetheless act reasonably to inform the client of actions the lawyer has taken on the client's behalf. Additionally, paragraph (a)(3) requires that the lawyer keep the client reasonably informed about the status of the matter, such as significant developments affecting the timing or the substance of the representation.

[4] A lawyer's regular communication with clients will minimize the occasions on which a client will need to request information concerning the representation. When a client makes a reasonable request for information, however, paragraph (a)(4) requires prompt compliance with the request, or if a prompt response

is not feasible, that the lawyer, or a member of the lawyer's staff, acknowledge receipt of the request and advise the client when a response may be expected. A lawyer should promptly respond to or acknowledge client communications.

Explaining Matters

[5] The client should have sufficient information to participate intelligently in decisions concerning the objectives of the representation and the means by which they are to be pursued, to the extent the client is willing and able to do so. Adequacy of communication depends in part on the kind of advice or assistance that is involved. For example, when there is time to explain a proposal made in a negotiation, the lawyer should review all important provisions with the client before proceeding to an agreement. In litigation a lawyer should explain the general strategy and prospects of success and ordinarily should consult the client on tactics that are likely to result in significant expense or to injure or coerce others. On the other hand, a lawyer ordinarily will not be expected to describe trial or negotiation strategy in detail. The guiding principle is that the lawyer should fulfill reasonable client expectations for information consistent with the duty to act in the client's best interests, and the client's overall requirements as to the character of representation. In certain circumstances, such as when a lawyer asks a client to consent to a representation affected by a conflict of interest, the client must give informed consent, as defined in Rule 1.0(e).

[6] Ordinarily, the information to be provided is that appropriate for a client who is a comprehending and responsible adult. However, fully informing the client according to this standard may be impracticable, for example, where the client is a child or suffers from diminished capacity. See Rule 1.14. When the client is an organization or group, it is often impossible or inappropriate to inform every one of its members about its legal affairs; ordinarily, the lawyer should address communications to the appropriate officials of the organization. See Rule 1.13. Where many routine matters are involved, a system of limited or occasional reporting may be arranged with the client.

Withholding Information

[7] In some circumstances, a lawyer may be justified in delaying transmission of information when the client would be likely to react imprudently to an immediate communication. Thus, a lawyer might withhold a psychiatric diagnosis of a client when the examining psychiatrist indicates that disclosure would harm the client. A lawyer may not withhold information to serve the lawyer's own interests or convenience or the interests or convenience of another person. Rules or court orders governing litigation may provide that information supplied to a lawyer may not be disclosed to the client.

Disclosures Regarding Insurance

[8] Paragraph (c) does not apply to lawyers in full-time government practice or full-time lawyers employed as in-house counsel and who do not have any private clients.

[9] Lawyers may use the following language in making the disclosures required by this rule:

(i) No insurance or insurance below required amounts when retained: "Pennsylvania Rule of Professional Conduct 1.4(c) requires that you, as the client, be informed in writing if a lawyer does not have professional liability insurance of at least $100,000 per occurrence and $300,000 in the aggregate per year and if, at any time, a lawyer's professional liability insurance drops below either of those amounts or a lawyer's professional liability insurance coverage is terminated. You are therefore advised that (name of attorney or firm) does not have professional liability insurance coverage of at least $100,000 per occurrence and $300,000 in the aggregate per year."

(ii) Insurance drops below required amounts: "Pennsylvania Rule of Professional Conduct 1.4(c) requires that you, as the client, be informed in writing if a lawyer does not have professional liability insurance of at least $100,000 per occurrence and $300,000 in the aggregate per year and if, at any time, a lawyer's professional liability insurance drops below either of those amounts or a lawyer's professional liability insurance coverage is terminated. You are therefore advised that (name of attorney or firm)'s professional liability insurance dropped below at least $100,000 per occurrence and $300,000 in the aggregate per year as of (date)."

(iii) Insurance terminated: "Pennsylvania Rule of Professional Conduct 1.4(c) requires that you, as the client, be informed in writing if a lawyer does not have professional liability insurance of at least $100,000 per occurrence and $300,000 in the aggregate per year and if, at any time, a lawyer's professional liability insurance drops below either of those amounts or a lawyer's professional

liability insurance coverage is terminated. You are therefore advised that (name of attorney or firm)'s professional liability insurance has been terminated as of (date)."

[10] A lawyer or firm maintaining professional liability insurance coverage in at least the minimum amounts provided in paragraph (c) is not subject to the disclosure obligations mandated by the rule if such coverage is subject to commercially reasonable deductibles, retention or co-insurance. Deductibles, retentions or co-insurance offered, from time to time, in the marketplace for professional liability insurance for the size of firm and coverage limits purchased will be deemed to be commercially reasonable.

Rule 1.5 Fees

(a) A lawyer shall not enter into an agreement for, charge, or collect an illegal or clearly excessive fee. The factors to be considered in determining the propriety of a fee include the following:

(1) whether the fee is fixed or contingent;

(2) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

(3) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;

(4) the fee customarily charged in the locality for similar legal services;

(5) the amount involved and the results obtained;

(6) the time limitations imposed by the client or by the circumstances;

(7) the nature and length of the professional relationship with the client; and

(8) the experience, reputation, and ability of the lawyer or lawyers performing the services.

(b) When the lawyer has not regularly represented the client, the basis or rate of the fee shall be communicated to the client, in writing, before or within a reasonable time after commencing the representation.

(c) A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. A contingent fee agreement shall be in writing and shall state the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal, litigation and other expenses to be deducted from the recovery, and whether such expenses are to be deducted before or after the contingent fee is calculated. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination.

(d) A lawyer shall not enter into an arrangement for, charge, or collect:

(1) any fee in a domestic relations matter, the payment or amount of which is contingent upon the securing of a divorce or upon the amount of alimony or support; or

(2) a contingent fee for representing a defendant in a criminal case.

(e) A lawyer shall not divide a fee for legal services with another lawyer who is not in the same firm unless:

(1) the client is advised of and does not object to the participation of all the lawyers involved; and,

(2) the total fee of the lawyers is not illegal or clearly excessive for all legal services they rendered the client.

Comment:

Basis or Rate of Fee

[1] When the lawyer has regularly represented a client, they ordinarily will have evolved an understanding concerning the basis or rate of the fee. In a new client-lawyer relationship, however, an understanding as to the fee should be promptly established. It is not necessary to recite all the factors that underlie the basis of the fee, but only those that are directly involved in its computation. It is sufficient, for example, to state that the basic rate is an hourly charge or a fixed amount or an estimated amount, or to identify the factors that may be taken into account in finally fixing the fee. When developments occur during the representation that render an earlier estimate substantially inaccurate, a revised estimate should be provided to the client. A written statement concerning the fee reduces the possibility of misunderstanding. Furnishing the client with a simple memorandum or a copy of the lawyer's customary fee schedule is sufficient if the basis or rate of the fee is set forth.

Terms of Payment

[2] A lawyer may require advance payment of a fee, but is obliged to return any unearned portion. See Rule 1.16(d). A lawyer may accept property in payment for services, such as an ownership interest in an enterprise, providing this does not involve acquisition of a proprietary interest in the cause of action or subject matter of the litigation contrary to Rule 1.8(i). However, a fee paid in property instead of money may be subject to special scrutiny because it involves questions concerning both the value of the services and the lawyer's special knowledge of the value of the property.

[3] An agreement may not be made whose terms might induce the lawyer improperly to curtail services for the client or perform them in a way contrary to the client's interest. For example, a lawyer should not enter into an agreement whereby services are to be provided only up to a stated amount when it is foreseeable that more extensive services probably will be required, unless the situation is adequately explained to the client. Otherwise, the client might have to bargain for further assistance in the midst of a proceeding or transaction. However, it is proper to define the extent of services in light of the client's ability to pay. A lawyer should not exploit a fee arrangement based primarily on hourly charges by using wasteful procedures. When there is doubt whether a contingent fee is consistent with the client's best interest, the lawyer should offer the client alternative bases for the fee and explain their implications. Applicable law may impose limitations on contingent fees, such as a ceiling on the percentage.

Division of Fee

[4] A division of fee is a single billing to a client covering the fee of two or more lawyers who are not in the same firm. A division of fee facilitates association of more than one lawyer in a matter in which neither alone could serve the client as well, and most often is used when the fee is contingent and the division is between a referring lawyer and a trial specialist. Paragraph (e) permits the lawyers to divide a fee if the total fee is not illegal or excessive and the client is advised and does not object. It does not require disclosure to the client of the share that each lawyer is to receive.

Successor Counsel in Contingency Fee Matters

[5] Unlike the situation in [4], which addresses division of fee between lawyers from different firms who are simultaneously representing a client, there may arise a situation where a client enters a contingent fee agreement with one lawyer ("predecessor counsel"), terminates that lawyer's services without cause, and enters a new contingent fee agreement with a different lawyer ("successor counsel"). In such a situation, and pursuant to a lawyer's duties as set forth in paragraphs (b) and (c), successor counsel must notify the client, in writing, that some portion of the fee may be due to or claimed by predecessor counsel for services performed prior to the termination, and should discuss with the client the effect of that claim on successor counsel's proposed fee agreement. If successor counsel will be involved in negotiating fees with predecessor counsel on the client's behalf, successor counsel should evaluate whether the circumstances give rise to a conflict of interest with the client and, if so, must obtain appropriate informed consent to the conflict as set forth in Rule 1.7. If a dispute arises regarding distribution of the recovery, successor counsel must hold the disputed portion of the funds in trust pending resolution, in accordance with Rule 1.15(f). *See* ABA Formal Opinion 487 (June

18, 2019) (relating to successive contingent fee agreements). While part II.A of Formal Opinion 487 would require the client's written informed consent, Rule 1.7 does not require a writing. However, if informed consent is deemed necessary under the circumstances, written consent may benefit both the client and successor counsel for the reasons set forth in Explanatory Comment [20] to Rule 1.7.

Disputes over Fees

[6] If a procedure has been established for resolution of fee disputes, such as an arbitration or mediation procedure established by the bar, the lawyer should conscientiously consider submitting to it. Law may prescribe a procedure for determining a lawyer's fee, for example, in representation of an executor or administrator, a class or a person entitled to a reasonable fee as part of the measure of damages. The lawyer entitled to such a fee and a lawyer representing another party concerned with the fee should comply with the prescribed procedure.

[7] It is Disciplinary Board policy that allegations of excessive fees charged are initially referred to Fee Dispute Committees for resolution.

Rule 1.6 Confidentiality of Information

(a) A lawyer shall not reveal information relating to representation of a client unless the client gives informed consent, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraphs (b) and (c).

(b) A lawyer shall reveal such information if necessary to comply with the duties stated in Rule 3.3.

(c) A lawyer may reveal such information to the extent that the lawyer reasonably believes necessary:

(1) to prevent reasonably certain death or substantial bodily harm;

(2) to prevent the client from committing a criminal act that the lawyer believes is likely to result in substantial injury to the financial interests or property of another;

(3) to prevent, mitigate or rectify the consequences of a client's criminal or fraudulent act in the commission of which the lawyer's services are being or had been used;

(4) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim or disciplinary proceeding against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client;

(5) to secure legal advice about the lawyer's compliance with these Rules;

(6) to effectuate the sale of a law practice consistent with Rule 1.17;

(7) to detect and resolve conflicts of interest from the lawyer's change of employment or from changes in the composition or ownership of a firm, but only if the revealed information would not compromise the attorney-client privilege or otherwise prejudice the client; or,

(8) to comply with other law or court order.

(d) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.

(e) The duty not to reveal information relating to representation of a client continues after the client-lawyer relationship has terminated.

Comment:

[1] This Rule governs the disclosure by a lawyer of information relating to the representation of a client during the lawyer's representation of the client. See Rule 1.18 for the lawyer's duties with respect to information provided to the lawyer by a prospective client, Rule 1.9(c)(2) for the lawyer's duty not to reveal information relating to the lawyer's prior representation of a former client and Rules 1.8(b) and 1.9(c)(1) for the lawyer's duties with respect to the use of such information to the disadvantage of clients and former clients.

[2] A fundamental principle in the client-lawyer relationship is that, in the absence of the client's informed consent, the lawyer must not reveal information relating to the representation. See Rule 1.0(e) for the definition of informed consent. This contributes to the trust that is the hallmark of the client-lawyer relationship. The client is thereby encouraged to seek legal assistance and to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter. The lawyer needs this information to represent the client effectively and, if necessary, to advise the client to refrain from wrongful conduct. Almost without exception, clients come to lawyers in order to determine their rights and what is, in the complex of laws and regulations, deemed to be legal and correct. Based upon experience, lawyers know that almost all clients follow the advice given, and the law is upheld.

[3] The principle of client-lawyer confidentiality is given effect by related bodies of law: the attorney-client privilege, the work product doctrine and the rule of confidentiality established in professional ethics. The attorney-client privilege and work-product doctrine apply in judicial and other proceedings in which a lawyer may be called as a witness or otherwise required to produce evidence concerning a client. The rule of client-lawyer confidentiality applies in situations other than those where evidence is sought from the lawyer through compulsion of law. The confidentiality rule, for example, applies not only to matters communicated in confidence by the client but also to all information relating to the representation, whatever its source. A lawyer may not disclose such information except as authorized or required by the Rules of Professional Conduct or other law. See also Scope.

[4] Paragraph (a) prohibits a lawyer from revealing information relating to the representation of a client. This prohibition also applies to disclosures by a lawyer that do not in themselves reveal protected information but could reasonably lead to the discovery of such information by a third person. A lawyer's use of a hypothetical to discuss issues relating to the representation is permissible so long as there is no reasonable likelihood that the listener will be able to ascertain the identity of the client or the situation involved.

[5] A lawyer has duties of disclosure to a tribunal under Rule 3.3(a) that may entail disclosure of information relating to the representation. Rule 1.6(b) recognizes the paramount nature of this obligation.

Authorized Disclosure

[6] Except to the extent that the client's instructions or special circumstances limit that authority, a lawyer is impliedly authorized to make disclosures about a client when appropriate in carrying out the representation. In some situations, for example, a lawyer may be impliedly authorized to admit a fact that cannot properly be disputed or to make a disclosure that facilitates a satisfactory conclusion to a matter. Lawyers in a firm may, in the course of the firm's practice, disclose to each other information relating to a client of the firm, unless the client has instructed that particular information be confined to specified lawyers.

Detection of Conflicts of Interests

[7] Although the public interest is usually best served by a strict rule requiring lawyers to preserve the confidentiality of information relating to the representation of their clients, the confidentiality rule is subject to limited exceptions. In becoming privy to information about a client, a lawyer may foresee that the client intends or learn that the client has caused serious harm to another person. However, to the extent that a lawyer is required or permitted to disclose a client's purposes or conduct, the client may be inhibited from revealing facts that would enable the lawyer effectively to represent the client. Generally, the public interest is better served if full disclosure by clients to their lawyers is encouraged rather than inhibited. With limited exceptions, information relating to the representation must be kept confidential by a lawyer, as stated in paragraph (a).

[8] Where human life is threatened, the client is or has been engaged in criminal or fraudulent conduct, or the integrity of the lawyer's own conduct is involved, the principle of confidentiality may have to yield, depending on the lawyer's knowledge about and relationship to the conduct in question.

[9] Several situations must be distinguished:

[10] First, a lawyer may foresee certain death or serious bodily harm to another person. Paragraph (c)(1) recognizes the overriding value of life and physical integrity and permits disclosure reasonably necessary to prevent reasonably certain death or substantial bodily harm. Such harm is reasonably certain to occur if it will be suffered imminently or there is a present and substantial threat that a person will suffer such harm at a later date if the lawyer fails to take action necessary to eliminate the threat. Thus, a lawyer who knows that a client has accidentally discharged toxic waste into a town's water supply may reveal this information to the authorities if there is a present and substantial risk that a person who drinks the water will contract a life-threatening or debilitating disease and that the lawyer's disclosure is necessary to eliminate the threat or reduce the number of victims.

[11] Second, paragraph (c)(2) is a limited exception to the rule of confidentiality that permits the lawyer to reveal information to the extent necessary to enable affected persons or appropriate authorities to prevent the client from committing a crime that is reasonably certain to result in substantial injury to the financial or property interests of another. Disclosure is permitted under paragraph (c)(2) only where the lawyer reasonably believes that such threatened action is a crime; the lawyer may not substitute his or her own sense of wrongdoing for that of society at large as reflected in the applicable criminal laws. The client can, of course, prevent such disclosure by refraining from the wrongful conduct.

[12] Third, a lawyer may not counsel or assist a client in conduct that is criminal or fraudulent. See Rule 1.2(d). To avoid assisting a client's criminal or fraudulent conduct, the lawyer may have to reveal information relating to the representation. Rule 1.6(c)(3) permits doing so.

[13] Fourth, a lawyer may have been innocently involved in past conduct by a client that was criminal or fraudulent. In such a situation, the lawyer did not violate Rule 1.2(d). However, if the lawyer's services were made an instrument of the client's crime or fraud, the lawyer has a legitimate and overriding interest in being able to rectify the consequences of such conduct. Rule 1.6(c)(3) gives the lawyer professional discretion to reveal information relating to the representation to the extent necessary to accomplish rectification.

[14] Fifth, where a legal claim or disciplinary charge alleges complicity of the lawyer in a client's conduct or other misconduct of the lawyer involving representation of the client, the lawyer may respond to the extent the lawyer reasonably believes necessary to establish a defense. The same is true with respect to a claim involving the conduct or representation of a former client. Such a charge can arise in a civil, criminal, disciplinary or other proceeding and can be based on a wrong allegedly committed by the lawyer against the client or on a wrong alleged by a third person; for example, a person claiming to have been defrauded by the lawyer and client acting together. If the lawyer is charged with wrongdoing in which the client's conduct is implicated, the rule of confidentiality should not prevent the lawyer from defending against the charge. The lawyer's right to respond arises when an assertion of such complicity has been made. Paragraph (c)(4) does not require the lawyer to await the commencement of an action or proceeding that charges such complicity, so that the defense may be established by responding directly to a third party who has made such an assertion. The right to defend also applies, of course, where a proceeding has been commenced.

[15] Sixth, a lawyer entitled to a fee is permitted by paragraph (c)(4) to prove the services rendered in an action to collect it. This aspect of the Rule expresses the principle that the beneficiary of a fiduciary relationship may not exploit it to the detriment of the fiduciary.

[16] Seventh, a lawyer’s confidentiality obligations do not preclude a lawyer from securing confidential legal advice about the lawyer’s personal responsibility to comply with these Rules. In most situations, disclosing information to secure such advice will be impliedly authorized for the lawyer to carry out the representation. Even when the disclosure is not impliedly authorized, paragraph (c)(5) permits such disclosure because of the importance of a lawyer’s compliance with the Rules of Professional Conduct.

[17] Eighth, it is recognized that the due diligence associated with the sale of a law practice authorized under Rule 1.17 may necessitate the limited disclosure of certain otherwise confidential information. Paragraph (c)(6) permits such disclosure. However, as stated above, the lawyer must make every effort

practicable to avoid unnecessary disclosure of information relating to a representation, to limit disclosure to those having a need to know it, and to obtain appropriate arrangements minimizing the risk of disclosure.

[18] Other law may require that a lawyer disclose information about a client. Whether such a law supersedes Rule 1.6 is a question of law beyond the scope of these Rules. When disclosure of information relating to the representation appears to be required by other law, the lawyer must discuss the matter with the client to the extent required by Rule 1.4. If, however, the other law supersedes this Rule and requires disclosure, paragraph (c)(8) permits the lawyer to make such disclosures as are necessary to comply with the law.

[19] Paragraph (c)(7) recognizes that lawyers in different firms may need to disclose limited information to each other to detect and resolve conflicts of interest, such as when a lawyer is considering an association with another firm, two or more firms are considering a merger, or a lawyer is considering the purchase of a law practice. See Rule 1.17, Comment [4]. Under these circumstances, lawyers and law firms are permitted to disclose limited information, but only once substantive discussions regarding the new relationship have occurred. Any such disclosure should ordinarily include no more than the identity of the persons and entities involved in a matter, a brief summary of the general issues involved, and information about whether the matter has terminated. Even this limited information, however, should be disclosed only to the extent reasonably necessary to detect and resolve conflicts of interest that might arise from the possible new relationship. Moreover, the disclosure of any information is prohibited if it would compromise the attorney-client privilege or otherwise prejudice the client (e.g., the fact that a corporate client is seeking advice on a corporate takeover that has not been publicly announced; that a person has consulted a lawyer about the possibility of divorce before the person's intentions are known to the person's spouse; or that a person has consulted a lawyer about a criminal investigation that has not led to a public charge). Under those circumstances, paragraph (a) prohibits disclosure unless the client or former client gives informed consent. A lawyer’s fiduciary duty to the lawyer’s firm may also govern a lawyer’s conduct when exploring an association with another firm and is beyond the scope of these Rules.

[20] Any information disclosed pursuant to paragraph (c)(7) may be used or further disclosed only to the extent necessary to detect and resolve conflicts of interest. Paragraph (c)(7) does not restrict the use of information acquired by means independent of any disclosure pursuant to paragraph (c)(7). Paragraph (c)(7) also does not affect the disclosure of information within a law firm when the disclosure is otherwise authorized, see Comment [6], such as when a lawyer in a firm discloses information to another lawyer in the same firm to detect and resolve conflicts of interest that could arise in connection with undertaking a new representation.

[21] A lawyer may be ordered to reveal information relating to the representation of a client by a court or by another tribunal or governmental entity claiming authority pursuant to other law to compel the disclosure. Absent informed consent of the client to do otherwise, the lawyer should assert on behalf of the client all nonfrivolous claims that the order is not authorized by other law or that the information sought is protected against disclosure by the attorney-client privilege or other applicable law. In the event of an adverse ruling, the lawyer must consult with the client about the possibility of appeal to the extent required by Rule 1.4. Unless review is sought, paragraph (c)(8) permits the lawyer to comply with the court’s order.

[22] Paragraph (c) permits disclosure only to the extent the lawyer reasonably believes the disclosure is necessary to accomplish one of the purposes specified. Where practicable, the lawyer should first seek to persuade the client to take suitable action to obviate the need for disclosure. In any case, a disclosure adverse to the client’s interest should be no greater than the lawyer reasonably believes necessary to accomplish the purpose. If the disclosure will be made in connection with a judicial proceeding, the disclosure should be made in a manner that limits access to the information to the tribunal or other persons having a need to know it and appropriate protective orders or other arrangements should be sought by the lawyer to the fullest extent practicable.

[23] Paragraph (c) permits but does not require the disclosure of information relating to a client’s representation to accomplish the purposes specified in paragraphs (c)(1) through (c)(8). In exercising the discretion conferred by this Rule, the lawyer may consider such factors as the nature of the lawyer’s relationship with the client and with those who might be injured by the client, the lawyer’s own involvement in the transaction and factors that may extenuate the conduct in question. A lawyer's decision not to disclose as permitted by paragraph (c) does not violate this Rule. Disclosure may be required, however, by other Rules. Some Rules require disclosure only if such disclosure would be permitted by paragraph (c). See Rules

1.2(d), 4.1(b), 8.1, and 8.3. Rule 3.3, on the other hand, requires disclosure in some circumstances regardless of whether such disclosure is permitted by this Rule. See Rule 3.3(c).

Withdrawal

[24] If the lawyer's services will be used by the client in materially furthering a course of criminal or fraudulent conduct, the lawyer must withdraw, as stated in Rule 1.16(a)(1). After withdrawal the lawyer is required to refrain from making disclosure of the client's confidences, except as otherwise provided in Rule 1.6. Neither this Rule nor Rule 1.8(b) nor Rule 1.16(d) prevents the lawyer from giving notice of the fact of withdrawal, and the lawyer may also withdraw or disaffirm any opinion, document, affirmation, or the like. Where the client is an organization, the lawyer may be in doubt whether contemplated conduct will actually be carried out by the organization. Where necessary to guide conduct in connection with this Rule, the lawyer may make inquiry within the organization as indicated in Rule 1.13(b).

Acting Competently to Preserve Confidentiality

[25] Pursuant to paragraph (d), a lawyer should act in accordance with court policies governing disclosure of sensitive or confidential information, including the Case Records Public Access Policy of the Unified Judicial System of Pennsylvania. Paragraph (d) requires a lawyer to act competently to safeguard information relating to the representation of a client against unauthorized access by third parties and against inadvertent or unauthorized disclosure by the lawyer or other persons who are participating in the representation of the client or who are subject to the lawyer's supervision. See Rules 1.1, 5.1, and 5.3. The unauthorized access to, or the inadvertent or unauthorized disclosure of, information relating to the representation of a client does not constitute a violation of paragraph (d) if the lawyer has made reasonable efforts to prevent the access or disclosure. Factors to be considered in determining the reasonableness of the lawyer's efforts include, but are not limited to, the sensitivity of the information, the likelihood of disclosure if additional safeguards are not employed, the cost of employing additional safeguards, the difficulty of implementing the safeguards, and the extent to which the safeguards adversely affect the lawyer's ability to represent clients (e.g., by making a device or important piece of software excessively difficult to use). A client may require the lawyer to implement special security measures not required by this Rule or may give informed consent to forgo security measures that would otherwise be required by this Rule. Whether a lawyer may be required to take additional steps to safeguard a client's information in order to comply with other law, such as state and federal laws that govern data privacy or that impose notification requirements upon the loss of, or unauthorized access to, electronic information, is beyond the scope of these Rules. For a lawyer's duties when sharing information with nonlawyers outside the lawyer's own firm, see Rule 5.3, Comments [3]-[4].

[26] When transmitting a communication that includes information relating to the representation of a client, the lawyer must take reasonable precautions to prevent the information from coming into the hands of unintended recipients. This duty, however, does not require that the lawyer use special security measures if the method of communication affords a reasonable expectation of privacy. Special circumstances, however, may warrant special precautions. Factors to be considered in determining the reasonableness of the lawyer's expectation of confidentiality include the sensitivity of the information and the extent to which the privacy of the communication is protected by law or by a confidentiality agreement. A client may require the lawyer to implement special security measures not required by this Rule or may give informed consent to the use of a means of communication that would otherwise be prohibited by this Rule. Whether a lawyer may be required to take additional steps in order to comply with other law, such as state and federal laws that govern data privacy, is beyond the scope of these Rules.

Former Client

[27] The duty of confidentiality continues after the client-lawyer relationship has terminated. See Rule 1.9(c)(2). See Rule 1.9(c)(1) for the prohibition against using such information to the disadvantage of the former client.

Lobbyists

[28] A lawyer who acts as a lobbyist on behalf of a client may disclose information relating to the representation in order to comply with any legal obligation imposed on the lawyer-lobbyist by the Legislature, the Executive Branch or an agency of the Commonwealth, or a local government unit which are consistent with the Rules of Professional Conduct. Such disclosure is explicitly authorized to carry out the representation. The Disciplinary Board of the Supreme Court shall retain jurisdiction over any violation of this Rule.

Rule 1.7 Conflict of Interest: Current Clients

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or,

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and,

(4) each affected client gives informed consent.

Comment:

General Principles

[1] Loyalty and independent judgment are essential elements in the lawyer's relationship to a client. Concurrent conflicts of interest can arise from the lawyer's responsibilities to another client, a former client or a third person or from the lawyer's own interests. For specific Rules regarding certain concurrent conflicts of interest, see Rule 1.8. For former client conflicts of interest, see Rule 1.9. For conflicts of interest involving prospective clients, see Rule 1.18. For the definition of "informed consent," see Rule 1.0(e).

[2] Resolution of a conflict of interest problem under this Rule requires the lawyer to: 1) clearly identify the client or clients; 2) determine whether a conflict of interest exists; 3) decide whether the representation may be undertaken despite the existence of a conflict, i.e., whether the conflict is consentable; and 4) if so, consult with the clients affected under paragraph (a) and obtain their informed consent. The clients affected under paragraph (a) include the clients referred to in paragraph (a)(1) and the clients whose representation might be materially limited under paragraph (a)(2).

[3] A conflict of interest may exist before representation is undertaken, in which event the representation must be declined, unless the lawyer obtains the informed consent of each client under the conditions of paragraph (b). To determine whether a conflict of interest exists, a lawyer should adopt reasonable procedures, appropriate for the size and type of firm and practice, to determine in both litigation and non-litigation matters the persons and issues involved. See also Comment to Rule 5.1. Ignorance caused by a failure to institute such procedures will not excuse a lawyer's violation of this Rule. As to whether a client-lawyer relationship exists or, having once been established, is continuing, see Comment to Rule 1.3 and Scope.

[4] If a conflict arises after representation has been undertaken, the lawyer ordinarily must withdraw from the representation, unless the lawyer has obtained the informed consent of the client under the conditions of paragraph (b). See Rule 1.16. Where more than one client is involved, whether the lawyer may continue to represent any of the clients is determined both by the lawyer's ability to comply with duties owed to the former client and by the lawyer's ability to represent adequately the remaining client or clients, given the lawyer's duties to the former client. See Rule 1.9. See also Comments [5] and [29].

[5] Unforeseeable developments, such as changes in corporate and other organizational affiliations or the addition or realignment of parties in litigation, might create conflicts in the midst of a representation,

as when a company sued by the lawyer on behalf of one client is bought by another client represented by the lawyer in an unrelated matter. Depending on the circumstances, the lawyer may have the option to withdraw from one of the representations in order to avoid the conflict. The lawyer must seek court approval where necessary and take steps to minimize harm to the clients. See Rule 1.16. The lawyer must continue to protect the confidences of the client from whose representation the lawyer has withdrawn. See Rule 1.9(c).

Identifying Conflicts of Interest: Directly Adverse

[6] Loyalty to a current client prohibits undertaking representation directly adverse to that client without that client's informed consent. Thus, absent consent, a lawyer may not act as an advocate in one matter against a person the lawyer represents in some other matter, even when the matters are wholly unrelated. The client as to whom the representation is directly adverse is likely to feel betrayed, and the resulting damage to the client-lawyer relationship is likely to impair the lawyer's ability to represent the client effectively. In addition, the client on whose behalf the adverse representation is undertaken reasonably may fear that the lawyer will pursue that client's case less effectively out of deference to the other client, i.e., that the representation may be materially limited by the lawyer's interest in retaining the current client. Similarly, a directly adverse conflict may arise when a lawyer is required to cross-examine a client who appears as a witness in a lawsuit involving another client, as when the testimony will be damaging to the client who is represented in the lawsuit. On the other hand, simultaneous representation in unrelated matters of clients whose interests are only economically adverse, such as representation of competing economic enterprises in unrelated litigation, does not ordinarily constitute a conflict of interest and thus may not require consent of the respective clients.

[7] Directly adverse conflicts can also arise in transactional matters. For example, if lawyer is asked to represent the seller of a business in negotiations with a buyer represented by the lawyer, not in the same transaction but in another, unrelated matter, the lawyer could not undertake the representation without the informed consent of each client.

[8] Even where there is no direct adverseness, a conflict of interest exists if there is a significant risk that a lawyer's ability to consider, recommend or carry out an appropriate course of action for the client will be materially limited as a result of the lawyer's other responsibilities or interests. For example, a lawyer asked to represent several individuals seeking to form a joint venture is likely to be materially limited in the lawyer's ability to recommend or advocate all possible positions that each might take because of the lawyer's duty of loyalty to the others. The conflict in effect forecloses alternatives that would otherwise be available to the client. The mere possibility of subsequent harm does not itself require disclosure and consent. The critical questions are the likelihood that a difference in interests will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client.

Lawyer's Responsibilities to Former Clients and Other Third Persons

[9] In addition to conflicts with other current clients, a lawyer's duties of loyalty and independence may be materially limited by responsibilities to former clients under Rule 1.9 or by the lawyer's responsibilities to other persons, such as fiduciary duties arising from a lawyer's service as a trustee, executor or corporate director.

Personal Interest Conflicts

[10] The lawyer's own interests should not be permitted to have an adverse effect on representation of a client. For example, if the probity of a lawyer's own conduct in a transaction is in serious question, it may be difficult or impossible for the lawyer to give a client detached advice. Similarly, when a lawyer has discussions concerning possible employment with an opponent of the lawyer's client, or with a law firm representing the opponent, such discussions could materially limit the lawyer's representation of the client. In addition, a lawyer may not allow related business interests to affect representation, for example, by referring clients to an enterprise in which the lawyer has an undisclosed financial interest. See Rule 5.8 for specific Rules that prohibit or restrict a lawyer's involvement in the offer, sale, or placement of investment products regardless of an actual conflict or the potential for conflict. See Rule 1.8 for specific Rules pertaining to a number of personal interest conflicts, including business transactions with clients. See also Rule 1.10 (personal interest conflicts under Rule 1.7 ordinarily are not imputed to other lawyers in a law firm).

[11] When lawyers representing different clients in the same matter or in substantially related matters are closely related by blood or marriage, there may be a significant risk that client confidences will be revealed and that the lawyer's family relationship will interfere with both loyalty and independent professional judgment. As a result, each client is entitled to know of the existence and implications of the relationship between the lawyers before the lawyer agrees to undertake the representation. Thus, a lawyer related to another lawyer, e.g., as parent, child, sibling or spouse, ordinarily may not represent a client in a matter where that lawyer is representing another party, unless each client gives informed consent. The disqualification arising from a close family relationship is personal and ordinarily is not imputed to members of firms with whom the lawyers are associated. See Rule 1.10.

[12] A lawyer is prohibited from engaging in sexual relationships with a client unless the sexual relationship predates the formation of the client-lawyer relationship. See Rule 1.8(j).

Interest of Person Paying for a Lawyer's Service

[13] A lawyer may be paid from a source other than the client, including a co-client, if the client is informed of that fact and consents and the arrangement does not compromise the lawyer's duty of loyalty or independent judgment to the client. See Rule 1.8(f). If acceptance of the payment from any other source presents a significant risk that the lawyer's representation of the client will be materially limited by the lawyer's own interest in accommodating the person paying the lawyer's fee or by the lawyer's responsibilities to a payer who is also a co-client, then the lawyer must comply with the requirements of paragraph (b) before accepting the representation, including determining whether the conflict is consentable and, if so, that the client has adequate information about the material risks of the representation.

Prohibited Representations

[14] Ordinarily, clients may consent to representation notwithstanding a conflict. However, as indicated in paragraph 1.7(b), some conflicts are nonconsentable, meaning that the lawyer involved cannot properly ask for such agreement or provide representation on the basis of the client's consent. When the lawyer is representing more than one client, the question of consentability must be resolved as to each client.

[15] Consentability is typically determined by considering whether the interests of the clients will be adequately protected if the clients are permitted to give their informed consent to representation burdened by a conflict of interest. Thus, under paragraph (b)(1), representation is prohibited if in the circumstances the lawyer cannot reasonably conclude that the lawyer will be able to provide competent and diligent representation. See Rule 1.1 (competence) and Rule 1.3 (diligence).

[16] Paragraph (b)(2) describes conflicts that are nonconsentable because the representation is prohibited by applicable law. For example, in some states substantive law provides that the same lawyer may not represent more than one defendant in a capital case, even with the consent of the clients, and under federal criminal statutes certain representations by a former government lawyer are prohibited, despite the informed consent of the former client. In addition, decisional law in some states limits the ability of a governmental client, such as a municipality, to consent to a conflict of interest.

[17] Paragraph (b)(3) describes conflicts that are nonconsentable because of the institutional interest in vigorous development of each client's position when the clients are aligned directly against each other in the same litigation or other proceeding before a tribunal. Whether clients are aligned directly against each other within the meaning of this paragraph requires examination of the context of the proceeding. Although this paragraph does not preclude a lawyer's multiple representation of adverse parties to a mediation (because mediation is not a proceeding before a "tribunal" under Rule 1.0(m)), such representation may be precluded by paragraph (b)(1).

Informed Consent

[18] Informed consent requires that each affected client be aware of the relevant circumstances and of the material and reasonably foreseeable ways that the conflict could have adverse effects on the interests of that client. See Rule 1.0(e) (informed consent). The information required depends on the nature of the conflict and the nature of the risks involved. When representation of multiple clients in a single matter is undertaken, the information must include the implications of the common representation, including possible effects on loyalty, confidentiality and the attorney-client privilege and the advantages and risks involved. See Comments [30] and [31] (effect of common representation on confidentiality).

[19] Under some circumstances it may be impossible to make the disclosure necessary to obtain consent. For example, when the lawyer represents different clients in related matters and one of the clients refuses to consent to the disclosure necessary to permit the other client to make an informed decision, the lawyer cannot properly ask the latter to consent. In some cases the alternative to common representation can be that each party may have to obtain separate representation with the possibility of incurring additional costs. These costs, along with the benefits of securing separate representation, are factors that may be considered by the affected client in determining whether common representation is in the client's interests.

Confirming Consent

[20] Paragraph (b) requires the lawyer to obtain the informed consent of the client to a concurrent conflict of interest. The client's consent need not be confirmed in writing to be effective. Rather, a writing tends to impress upon clients the seriousness of the decision the client is being asked to make and to avoid disputes or ambiguities that might later occur in the absence of a writing. See also Rule 1.0(b) (writing includes electronic transmission).

Revoking Consent

[21] A client who has given consent to a conflict may revoke the consent and, like any other client, may terminate the lawyer's representation at any time. Whether revoking consent to the client's own representation precludes the lawyer from continuing to represent other clients depends on the circumstances, including the nature of the conflict, whether the client revoked consent because of a material change in circumstances, the reasonable expectations of the other client and whether material detriment to the other clients or the lawyer would result.

Consent to Future Conflict

[22] Whether a lawyer may properly request a client to waive conflicts that might arise in the future is subject to the test of paragraph (b). The effectiveness of such waivers is generally determined by the extent to which the client reasonably understands the material risks that the waiver entails. The more comprehensive the explanation of the types of future representations that might arise and the actual and reasonably foreseeable adverse consequences of those representations, the greater the likelihood that the client will have the requisite understanding. Thus, if the client agrees to consent to a particular type of conflict with which the client is already familiar, then the consent ordinarily will be effective with regard to that type of conflict. If the consent is general and open-ended, then the consent ordinarily will be ineffective, because it is not reasonably likely that the client will have understood the material risks involved. On the other hand, if the client is an experienced user of the legal services involved and is reasonably informed regarding the risk that a conflict may arise, such consent is more likely to be effective, particularly if, e.g., the client is independently represented by other counsel in giving consent and the consent is limited to future conflicts unrelated to the subject of the representation. In any case, advance consent cannot be effective if the circumstances that materialize in the future are such as would make the conflict nonconsentable under paragraph (b).

Conflicts in Litigation

[23] Paragraph (b)(3) prohibits representation of opposing parties in the same litigation, regardless of the clients' consent. On the other hand, simultaneous representation of parties whose interests in litigation may conflict, such as co-plaintiffs or co-defendants, is governed by paragraph (a)(2). A conflict may exist by reason of substantial discrepancy in the parties' testimony, incompatibility in positions in relation to an opposing party or the fact that there are substantially different possibilities of settlement of the claims or liabilities in question. Such conflicts can arise in criminal cases as well as in civil cases. The potential for conflict of interest in representing multiple defendants in a criminal case is so grave that ordinarily a lawyer should decline to represent more than one co-defendant. On the other hand, common representation of persons having similar interests in civil litigation is proper if the requirements of paragraph (b) are met.

[24] Ordinarily a lawyer may take inconsistent legal positions in different tribunals at different times on behalf of different clients. The mere fact that advocating a legal position on behalf of one client might create precedent adverse to the interests of a client represented by the lawyer in an unrelated matter does not create a conflict of interest. A conflict of interest exists, however, if there is a significant risk that a lawyer's action on behalf of one client will materially limit the lawyer's effectiveness in representing another client in a different case, for example, when a decision favoring one client will create a precedent likely to seriously weaken the

position taken on behalf of the other client. Factors relevant in determining whether the clients need to be advised of the risk include: where the cases are pending, whether the issue is substantive or procedural, the temporal relationship between the matters, the significance of the issue to the immediate and long-term interests of the clients involved and the clients' reasonable expectations in retaining the lawyer. If there is significant risk of material limitation, then absent informed consent of the affected clients, the lawyer must refuse one of the representations or withdraw from one or both matters.

[25] When a lawyer represents or seeks to represent a class of plaintiffs or defendants in a class-action lawsuit, unnamed members of the class are ordinarily not considered to be clients of the lawyer for purposes of applying paragraph (a)(1) of this Rule. Thus, the lawyer does not typically need to get the consent of such a person before representing a client suing the person in an unrelated matter. Similarly, a lawyer seeking to represent an opponent in a class action does not typically need the consent of an unnamed member of the class whom the lawyer represents in an unrelated matter.

Nonlitigation Conflicts

[26] Conflicts of interest under paragraphs (a)(1) and (a)(2) arise in contexts other than litigation. For a discussion of directly adverse conflicts in transactional matters, see Comment [7]. Relevant factors in determining whether there is significant potential for material limitation include the duration and intimacy of the lawyer's relationship with the client or clients involved, the functions being performed by the lawyer, the likelihood that disagreements will arise and the likely prejudice to the client from the conflict. The question is often one of proximity and degree. See Comment [8].

[27] For example, conflict questions may arise in estate planning and estate administration. A lawyer may be called upon to prepare wills for several family members, such as husband and wife, and, depending upon the circumstances, a conflict of interest may be present. In estate administration the identity of the client may be unclear under the law of a particular jurisdiction. Under one view, the client is the fiduciary; under another view the client is the estate or trust, including its beneficiaries. In order to comply with conflict of interest rules, the lawyer should make clear the lawyer's relationship to the parties involved.

[28] Whether a conflict is consentable depends on the circumstances. For example, lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other, but common representation is permissible where the clients are generally aligned in interest even though there is some difference in interest among them. Thus, a lawyer may seek to establish or adjust a relationship between clients on an amicable and mutually advantageous basis, for example, in helping to organize a business in which two or more clients are entrepreneurs, working out the financial reorganization of an enterprise in which two or more clients have an interest or arranging a property distribution in settlement of an estate. The lawyer seeks to resolve potentially adverse interests by developing the parties' mutual interests. Otherwise, each party might have to obtain separate representation, with the possibility of incurring additional cost, complication or even litigation. Given these and other relevant factors, the clients may prefer that the lawyer act for all of them.

Special Considerations in Common Representation

[29] In considering whether to represent multiple clients in the same matter, a lawyer should be mindful that if the common representation fails because the potentially adverse interests cannot be reconciled, the result can be additional cost, embarrassment and recrimination. Ordinarily, the lawyer will be forced to withdraw from representing all of the clients if the common representation fails. In some situations, the risk of failure is so great the multiple representation is plainly impossible. For example, a lawyer cannot undertake common representation of clients where contentious litigation or negotiations between them are imminent or contemplated. Moreover, because the lawyer is required to be impartial between commonly represented clients, representation of multiple clients is improper when it is unlikely that impartiality can be maintained. Generally, if the relationship between the parties has already assumed antagonism, the possibility that the clients' interests can be adequately served by common representation is not very good. Other relevant factors are whether the lawyer subsequently will represent both parties on a continuing basis and whether the situation involves creating or terminating a relationship between the parties.

[30] A particularly important factor in determining the appropriateness of common representation is the effect on client-lawyer confidentiality and the attorney-client privilege. With regard to the attorney-client privilege, the prevailing rule is that, as between commonly represented clients, the privilege does not attach.

Hence, it must be assumed that if litigation eventuates between the clients, the privilege will not protect any such communications, and the clients should be so advised.

[31] As to the duty of confidentiality, continued common representation will almost certainly be inadequate if one client asks the lawyer not to disclose to the other client information relevant to the common representation. This is so because the lawyer has an equal duty of loyalty to each client, and each client has the right to be informed of anything bearing on the representation that might affect that client's interests and the right to expect that the lawyer will use that information to that client's benefit. See Rule 1.4. The lawyer should, at the outset of the common representation and as part of the process of obtaining each client's informed consent, advise each client that information will be shared and that the lawyer will have to withdraw if one client decides that some matter material to the representation should be kept from the other. In limited circumstances, it may be appropriate for the lawyer to proceed with the representation when the clients have agreed, after being properly informed, that the lawyer will keep certain information confidential. For example, the lawyer may reasonably conclude that failure to disclose one client's trade secrets to another client will not adversely affect representation involving a joint venture between the clients and agree to keep that information confidential with the informed consent of both clients.

[32] When seeking to establish or adjust a relationship between clients, the lawyer should make clear that the lawyer's role is not that of partisanship normally expected in other circumstances and, thus, that the clients may be required to assume greater responsibility for decisions than when each client is separately represented. Any limitations on the scope of the representation made necessary as a result of the common representation should be fully explained to the clients at the outset of the representation. See Rule 1.2(c).

[33] Subject to the above limitations, each client in the common representation has the right to loyal and diligent representation and the protection of Rule 1.9 concerning the obligations to a former client. The client also has the right to discharge the lawyer as stated in Rule 1.16.

Organizational Clients

[34] A lawyer who represents a corporation or other organization does not, by virtue of that representation, necessarily represent any constituent or affiliated organization, such as parent or subsidiary. See Rule 1.13(a). Thus, the lawyer for an organization is not barred from accepting representation adverse to an affiliate in an unrelated matter, unless the circumstances are such that the affiliate should also be considered a client of the lawyer, there is an understanding between the lawyer and the organizational client that the lawyer will avoid representation adverse to the client's affiliates, or the lawyer's obligations to either the organizational client or the new client are likely to limit materially the lawyer's representation of the other client.

[35] A lawyer for a corporation or other organization who is also a member of its board of directors should determine whether the responsibilities of the two roles may conflict. The lawyer may be called on to advise the corporation in matters involving actions of the directors. Consideration should be given to the frequency with which such situations may arise, the potential intensity of the conflict, the effect of the lawyer's resignation from the board and the possibility of the corporation's obtaining legal advice from another lawyer in such situations. If there is material risk that the dual role will compromise the lawyer's independence of professional judgment, the lawyer should not serve as a director or should cease to act as the corporation's lawyer when conflicts of interest arise. The lawyer should advise the other members of the board that in some circumstances matters discussed at board meetings while the lawyer is present in the capacity of director might not be protected by the attorney-client privilege and that conflict of interest considerations might require the lawyer's recusal as a director or might require the lawyer and the lawyer's firm to decline representation of the corporation in a matter.

Rule 1.8 Conflict of Interest: Current Clients: Specific Rules

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and,

(3) the client gives informed consent in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted or required by these Rules.

(c) A lawyer shall not solicit any substantial gift from a client, including a testamentary gift, or prepare on behalf of a client an instrument giving the lawyer or a person related to the lawyer any substantial gift unless the lawyer or other recipient of the gift is related to the client. For purposes of this paragraph, related persons include a spouse, child, grandchild, parent, grandparent or other relative or individual with whom the lawyer or the client maintains a close familial relationship.

(d) Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation.

(e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:

(1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and,

(2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

(1) the client gives informed consent;

(2) there is no interference with the lawyer’s independence of professional judgment or with the client-lawyer relationship; and,

(3) information relating to representation of a client is protected as required by Rule 1.6.

(g) A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregated agreement as to guilty or nolo contendere pleas, unless each client gives informed consent. The lawyer's disclosure shall include the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.

(h) A lawyer shall not

(1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement; or,

(2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith.

(i) A lawyer shall not acquire a proprietary interest in a cause of action that the lawyer is conducting for a client, except that the lawyer may:

(1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and,

(2) contract with a client for a reasonable contingent fee in a civil case.

(j) A lawyer shall not have sexual relations with a client unless a consensual relationship existed between them when the client-lawyer relationship commenced.

(k) While lawyers are associated in a firm, a prohibition in the foregoing paragraphs (a) through (i) that applies to any one of them shall apply to all of them.

Comment:

Business Transactions Between Client and Lawyer

[1] A lawyer's legal skill and training, together with the relationship of trust and confidence between lawyer and client, create the possibility of overreaching when the lawyer participates in a business, property or financial transaction with a client, for example, a loan or sales transaction or a lawyer investment on behalf of a client. The requirements of paragraph (a) must be met even when the transaction is not closely related to the subject matter of the representation, as when a lawyer drafting a will for a client learns that the client needs money for unrelated expenses and offers to make a loan to the client. The Rule applies to lawyers engaged in the sale of goods or services related to the practice of law, for example, the sale of title insurance or investment services to existing clients of the lawyer's legal practice. See Rule 5.7. But see Rule 5.8 for specific Rules that prohibit or restrict a lawyer's involvement in the offer, sale, or placement of investment products regardless of an actual conflict or the potential for conflict. Rule 1.8 also applies to lawyers purchasing property from estates they represent. It does not apply to ordinary fee arrangements between client and lawyer, which are governed by Rule 1.5, although its requirements must be met when the lawyer accepts an interest in the client's business or other nonmonetary property as payment of all or part of a fee. In addition, the Rule does not apply to standard commercial transactions between the lawyer and the client for products or services that the client generally markets to others, for example, banking or brokerage services, medical services, products manufactured or distributed by the client, and utilities services. In such transactions, the lawyer has no advantage in dealing with the client, and the restrictions in paragraph (a) are unnecessary and impracticable.

[2] Paragraph (a)(1) requires that the transaction itself be fair to the client and that its essential terms be communicated to the client, in writing, in a manner that can be reasonably understood. Paragraph (a)(2) requires that the client also be advised, in writing, of the desirability of seeking the advice of independent legal counsel. It also requires that the client be given a reasonable opportunity to obtain such advice. Paragraph (a)(3) requires that the lawyer obtain the client's informed consent, in a writing signed by the client, both to the essential terms of the transaction and to the lawyer's role. When necessary, the lawyer should discuss both the material risks of the proposed transaction, including any risk presented by the lawyer's involvement, and the existence of reasonably available alternatives and should explain why the advice of independent legal counsel is desirable. See Rule 1.0(e) (definition of "Informed consent").

[3] The risk to a client is greatest when the client expects the lawyer to represent the client in the transaction itself or when the lawyer's financial interest otherwise poses a significant risk that the lawyer's representation of the client will be materially limited by the lawyer's financial interest in the transaction. Here the lawyer's role requires that the lawyer must comply, not only with the requirements of paragraph (a), but also with the requirements of Rule 1.7. Under that Rule, the lawyer must disclose the risks associated with the lawyer's dual role as both legal adviser and participant in the transaction, such as the risk that the lawyer will structure the transaction or give legal advice in a way that favors the lawyer's interests at the expense of the client. Moreover, the lawyer must obtain the client's informed consent. In some cases, the lawyer's interest may be such that Rule 1.7 will preclude the lawyer from seeking the client's consent to the transaction.

[4] If the client is independently represented in the transaction, paragraph (a)(2) of this Rule is inapplicable, and the paragraph (a)(1) requirement for full disclosure is satisfied either by a written disclosure by the lawyer involved in the transaction or by the client's independent counsel. The fact that the client was independently represented in the transaction is relevant in determining whether the agreement was fair and reasonable to the client as paragraph (a)(1) further requires.

Use of Information Related to Representation

[5] Use of information relating to the representation to the disadvantage of the client violates the lawyer's duty of loyalty. Paragraph (b) applies when the information is used to benefit either the lawyer or a third person, such as another client or business associate of the lawyer. For example, if a lawyer learns that a client intends to purchase and develop several parcels of land, the lawyer may not use that information to

purchase one of the parcels in competition with the client or to recommend that another client make such a purchase. The Rule does not prohibit uses that do not disadvantage the client. For example, a lawyer who learns a government agency's interpretation of trade legislation during the representation of one client may properly use that information to benefit other clients. Paragraph (b) prohibits disadvantageous use of client information unless the client gives informed consent, except as permitted or required by these Rules. See Rules 1.2(d), 1.6, 1.9(c), 3.3, 4.1(b), 8.1, and 8.3.

Gifts to Lawyers

[6] A lawyer may accept a gift from a client, if the transaction meets general standards of fairness. For example, a simple gift such as a present given at a holiday or as a token of appreciation is permitted. If a client offers the lawyer a more substantial gift, paragraph (c) does not prohibit the lawyer from accepting it, although such a gift may be voidable by the client under the doctrine of undue influence, which treats client gifts as presumptively fraudulent. In any event, due to concerns about overreaching and imposition on clients, a lawyer may not suggest that a substantial gift be made to the lawyer or for the lawyer's benefit, except where the lawyer is related to the client as set forth in paragraph (c).

[7] If effectuation of a substantial gift requires preparing a legal instrument such as a will or conveyance, the client should have the detached advice that another lawyer can provide. The sole exception to this Rule is where the client is a relative of the donee.

[8] This Rule does not prohibit a lawyer from seeking to have the lawyer or a partner or associate of the lawyer named as executor of the client's estate or to another potentially lucrative fiduciary position. Nevertheless, such appointments will be subject to the general conflict of interest provision in Rule 1.7 when there is a significant risk that the lawyer's interest in obtaining the appointment will materially limit the lawyer's independent professional judgment in advising the client concerning the choice of an executor or other fiduciary. In obtaining the client's informed consent to the conflict, the lawyer should advise the client concerning the nature and extent of the lawyer's financial interest in the appointment, as well as the availability of alternative candidates for the position.

Literary Rights

[9] An agreement by which a lawyer acquires literary or media rights concerning the conduct of the representation creates a conflict between the interests of the client and the personal interests of the lawyer. Measures suitable in the representation of the client may detract from the publication value of an account of the representation. Paragraph (d) does not prohibit a lawyer representing a client in a transaction concerning literary property from agreeing that the lawyer’s fee shall consist of a share in ownership in the property, if the arrangement conforms to Rule 1.5 and paragraphs (a) and (i).

Financial Assistance

[10] Lawyers may not subsidize lawsuits or administrative proceedings brought on behalf of their clients, including making or guaranteeing loans to their clients for living expenses, because to do so would encourage clients to pursue lawsuits that might not otherwise be brought and because such assistance gives lawyers too great a financial stake in the litigation. These dangers do not warrant a prohibition on a lawyer lending a client court costs and litigation expenses, including the expenses of medical examination and the costs of obtaining and presenting evidence, because these advances are virtually indistinguishable from contingent fees and help ensure access to the courts. Similarly, an exception allowing lawyers representing indigent clients to pay court costs and litigation expenses regardless of whether these funds will be repaid is warranted.

Person Paying for a Lawyer's Services

[11] Lawyers are frequently asked to represent a client under circumstances in which a third person will compensate the lawyer, in whole or in part. The third person might be a relative or friend, an indemnitor (such as a liability insurance company) or a co-client (such as a corporation sued along with one or more of its employees). Because third-party payers frequently have interests that differ from those of the client, including interests in minimizing the amount spent on the representation and in learning how the representation is progressing, lawyers are prohibited from accepting or continuing such representations unless the lawyer determines that there will be no interference with the lawyer's independent professional judgment and there is informed consent from the client. See also Rule 5.4(c) (prohibiting interference with a lawyer's

professional judgment by one who recommends, employs or pays the lawyer to render legal services for another).

[12] Sometimes, it will be sufficient for the lawyer to obtain the client's informed consent regarding the fact of the payment and the identity of the third-party payer. If, however, the fee arrangement creates a conflict of interest for the lawyer, then the lawyer must comply with Rule. 1.7. The lawyer must also conform to the requirements of Rule 1.6 concerning confidentiality. Under Rule 1.7(a), a conflict of interest exists if there is significant risk that the lawyer's representation of the client will be materially limited by the lawyer's own interest in the fee arrangement or by the lawyer's responsibilities to the third-party payer (for example, when the third-party payer is a co-client). Under Rule 1.7(b), the lawyer may accept or continue the representation with the informed consent of each affected client, unless the conflict is nonconsentable under that paragraph.

Aggregate Settlements

[13] Differences in willingness to make or accept an offer of settlement are among the risks of common representation of multiple clients by a single lawyer. Under Rule 1.7, this is one of the risks that should be discussed before undertaking the representation, as part of the process of obtaining the clients' informed consent. In addition, Rule 1.2(a) protects each client's right to have the final say in deciding whether to accept or reject an offer of settlement and in deciding whether to enter a guilty or nolo contendere plea in a criminal case. The rule stated in this paragraph is a corollary of both these Rules and provides that, before any settlement offer or plea bargain is made or accepted on behalf of multiple clients, the lawyer must inform each of them about all the material terms of the settlement, including what the other clients will receive or pay if the settlement or plea offer is accepted. See also Rule 1.0(e) (definition of informed consent). Lawyers representing a class of plaintiffs or defendants, or those proceeding derivatively, may not have a full client-lawyer relationship with each member of the class; nevertheless, such lawyers must comply with applicable rules regulating notification of class members and other procedural requirements designed to ensure adequate protection of the entire class.

Limiting Liability and Settling Malpractice Claims

[14] Agreements prospectively limiting a lawyer's liability for malpractice are prohibited unless the client is independently represented in making the agreement because they are likely to undermine competent and diligent representation. Also, many clients are unable to evaluate the desirability of making such an agreement before a dispute has arisen, particularly if they are then represented by the lawyer seeking the agreement. This paragraph does not, however, prohibit a lawyer from entering into an agreement with the client to arbitrate legal malpractice claims, provided such agreements are enforceable and the client is fully informed of the scope and effect of the agreement. Nor does this paragraph limit the ability of lawyers to practice in the form of a limited-liability entity, where permitted by law, provided that each lawyer remains personally liable to the client for his or her own conduct and the firm complies with any conditions required by law. Nor does it prohibit an agreement in accordance with Rule 1.2 that defines the scope of the representation, although a definition of scope that makes the obligations of representation illusory will amount to an attempt to limit liability.

[15] Agreements settling a claim or a potential claim for malpractice are not prohibited by this Rule. Nevertheless, in view of the danger that a lawyer will take unfair advantage of an unrepresented client or former client, the lawyer must first advise such a person in writing of the appropriateness of independent representation in connection with such a settlement. In addition, the lawyer must give the client or former client a reasonable opportunity to find and consult independent counsel.

Acquiring Proprietary Interest in Litigation

[16] Paragraph (i) states the traditional general rule that lawyers are prohibited from acquiring a proprietary interest in litigation. Like paragraph (e), the general rule has its basis in common law champerty and maintenance and is designed to avoid giving the lawyer too great an interest in the representation. In addition, when the lawyer acquires an ownership interest in the subject of the representation, it will be more difficult for a client to discharge the lawyer if the client so desires. The Rule is subject to specific exceptions developed in decisional law and continued in these Rules. The exception for certain advances of the costs of litigation is set forth in paragraph (e). In addition, paragraph (i) sets forth exceptions for liens authorized by law to secure the lawyer's fees or expenses and contracts for reasonable contingent fees. The law of each jurisdiction determines which liens are authorized by law. These may include liens granted by statute, liens

originating in common law and liens acquired by contract with the client. When a lawyer acquires by contract a security interest in property other than that recovered through the lawyer's efforts in the litigation, such an acquisition is a business or financial transaction with a client and is governed by the requirements of paragraph (a). Contracts for contingent fees in civil cases are governed by Rule 1.5.

Client-Lawyer Sexual Relationships

[17] The relationship between lawyer and client is a fiduciary one in which the lawyer occupies the highest position of trust and confidence. The relationship is almost always unequal; thus, a sexual relationship between lawyer and client can involve unfair exploitation of the lawyer's fiduciary role, in violation of the lawyer's basic ethical obligation not to use the trust of the client to the client's disadvantage. In addition, such a relationship presents a significant danger that, because of the lawyer's emotional involvement, the lawyer will be unable to represent the client without impairment of the exercise of independent professional judgment. Moreover, a blurred line between the professional and personal relationships may make it difficult to predict to what extent client confidences will be protected by the attorney-client evidentiary privilege, since client confidences are protected by privilege only when they are imparted in the context of the client-lawyer relationship. Because of the significant danger of harm to client interests and because the client's own emotional involvement renders it unlikely that the client could give adequate informed consent, this Rule prohibits the lawyer from having sexual relations with a client regardless of whether the relationship is consensual and regardless of the absence of prejudice to the client.

[18] Sexual relationships that predate the client-lawyer relationship are not prohibited. Issues relating to the exploitation of the fiduciary relationship and client dependency are diminished when the sexual relationship existed prior to the commencement of the client-lawyer relationship. However, before proceeding with the representation in these circumstances, the lawyer should consider whether the lawyer's ability to represent the client will be materially limited by the relationship. See Rule 1.7(a)(2).

[19] When the client is an organization, paragraph (j) of this Rule prohibits a lawyer for the organization (whether inside counsel or outside counsel) from having a sexual relationship with a constituent of the organization who supervises, directs or regularly consults with that lawyer concerning the organization's legal matters.

Imputation of Prohibitions

[20] Under paragraph (k), a prohibition on conduct by an individual lawyer in paragraphs (a) through (i) also applies to all lawyers associated in a firm with the personally prohibited lawyer. For example, one lawyer in a firm may not enter into a business transaction with a client of another member of the firm without complying with paragraph (a), even if the first lawyer is not personally involved in the representation of the client. The prohibition set forth in paragraph (j) is personal and is not applied to associated lawyers.

Rule 1.9 Duties to Former Clients

(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person’s interests are materially adverse to the interests of the former client unless the former client gives informed consent.

(b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client

(1) whose interests are materially adverse to that person; and

(2) about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter;

unless the former client gives informed consent.

(c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:

(1) use information relating to the representation to the disadvantage of the former client except as these Rules would permit or require with respect to a client, or when the information has become generally known; or

(2) reveal information relating to the representation except as these Rules would permit or require with respect to a client.

Comment:

[1] After termination of a client-lawyer relationship, a lawyer has certain continuing duties with respect to confidentiality and conflicts of interest and thus may not represent another client except in conformity with this Rule. Under this Rule, for example, a lawyer could not properly seek to rescind on behalf of a new client a contract drafted on behalf of the former client. So also a lawyer who has prosecuted an accused person could not properly represent the accused in a subsequent civil action against the government concerning the same transaction. Nor could a lawyer who has represented multiple clients in a matter represent one of the clients against the others in the same or a substantially related matter after a dispute arose among the clients in that matter, unless all affected clients give informed consent. See Comment [9]. Current and former government lawyers must comply with this Rule to the extent required by Rule 1.11.

[2] The scope of a "matter" for purposes of this Rule depends on the facts of a particular situation or transaction. The lawyer's involvement in a matter can also be a question of degree. When a lawyer has been directly involved in a specific transaction, subsequent representation of other clients with materially adverse interests in that transaction clearly is prohibited. On the other hand, a lawyer who recurrently handled a type of problem for a former client is not precluded from later representing another client in a factually distinct problem of that type even though the subsequent representation involves a position adverse to the prior client. Similar considerations can apply to the reassignment of military lawyers between defense and prosecution functions within the same military jurisdictions. The underlying question is whether the lawyer was so involved in the matter that the subsequent representation can be justly regarded as a changing of sides in the matter in question.

[3] Matters are "substantially related" for purposes of this Rule if they involve the same transaction or legal dispute or if there otherwise is a substantial risk that confidential factual information as would normally have been obtained in the prior representation would materially advance the client's position in the subsequent matter. For example, a lawyer who has represented a businessperson and learned extensive private financial information about that person may not then represent that person's spouse in seeking a divorce. Similarly, a lawyer who has previously represented a client in securing environmental permits to build a shopping center would be precluded from representing neighbors seeking to oppose rezoning of the property on the basis of environmental considerations; however, the lawyer would not be precluded, on the grounds of substantial relationship, from defending a tenant of the completed shopping center in resisting eviction for nonpayment of rent. Information that has been disclosed to the public or to other parties adverse to the former client ordinarily will not be disqualifying. Information acquired in a prior representation may have been rendered obsolete by the passage of time, a circumstance that may be relevant in determining whether two representations are substantially related. In the case of an organizational client, general knowledge of the client's policies and practices ordinarily will not preclude a subsequent representation; on the other hand, knowledge of specific facts gained in a prior representation that are relevant to the matter in question ordinarily will preclude such a representation. A former client is not required to reveal the confidential information learned by the lawyer in order to establish a substantial risk that the lawyer has confidential information that could be used adversely to the former client's interests in the subsequent matter. A conclusion about the possession of such information may be based on the nature of the services the lawyer provided the former client and information that would in ordinary practice be learned by a lawyer providing such services.

Lawyers Moving Between Firms

[4] When lawyers have been associated with a firm but then end their association, the question of whether a lawyer should undertake representation is more complicated. There are several competing considerations. First, the client previously represented by the former firm must be reasonably assured that the principle of loyalty to the client is not compromised. Second, the Rule should not be so broadly cast as to preclude other persons from having reasonable choice of legal counsel. Third, the Rule should not unreasonably hamper lawyers from forming new associations and taking on new clients after having left a previous association. In this connection, it should be recognized that today many lawyers practice in firms, that many lawyers to some degree limit their practice to one field or another, and that many move from one

association to another several times in their careers. If the concept of imputation were applied with unqualified rigor, the result would be radical curtailment of the opportunity of lawyers to move from one practice setting to another and of the opportunity of clients to change counsel.

[5] Paragraph (b) operates to disqualify the lawyer only when the lawyer involved has actual knowledge information protected by Rules 1.6 and 1.9(c). Thus, if a lawyer while with one firm acquired no knowledge of information relating to a particular client of the firm, and that lawyer later joined another firm, neither the lawyer individually nor the second firm is disqualified from representing another client in the same or a related matter even though the interests of the two clients conflict. See Rule 1.10(b) for the restrictions on a firm once a lawyer becomes associated with a firm, including screening provisions. See Rule 1.10(c) for the restrictions on a firm once a lawyer has terminated association with the firm.

[6] Application of paragraph (b) depends on a situation's particular facts, aided by inferences, deductions or working presumptions that reasonably may be made about the way in which lawyers work together. A lawyer may have general access to files of all clients of a law firm and may regularly participate in discussions of their affairs; it should be inferred that such a lawyer in fact is privy to all information about all the firm's clients. In contrast, another lawyer may have access to the files of only a limited number of clients and participate in discussions of the affairs of no other clients; in the absence of information to the contrary, it should be inferred that such a lawyer in fact is privy to information about the clients actually served but not those of other clients. In such an inquiry, the burden of proof should rest upon the firm whose disqualification is sought.

[7] Independent of the question of disqualification of a firm, a lawyer changing professional association has a continuing duty to preserve confidentiality of information about a client formerly represented. See Rules 1.6 and 1.9(c).

[8] Paragraph (c) provides that information acquired by the lawyer in the course of representing a client may not subsequently be used or revealed by the lawyer to the disadvantage of the client. However, the fact that a lawyer has once served a client does not preclude the lawyer from using generally known information about that client when later representing another client.

[9] The provisions of this Rule are for the protection of former clients and can be waived if the client gives informed consent. See Rule 1.0(e). With regard to the effectiveness of an advance waiver, see Comment [22] to Rule 1.7. With regard to disqualification of a firm with which a lawyer is or was formerly associated, see Rule 1.10.

Rule 1.10 Imputation of Conflicts of Interest: General Rule

(a) While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7 or 1.9, unless the prohibition is based on a personal interest of the prohibited lawyer and does not present a significant risk of materially limiting the representation of the client by the remaining lawyers in the firm, or unless permitted by Rules 1.10(b) or (c).

(b) When a lawyer becomes associated with a firm, the firm may not knowingly represent a person in the same or a substantially related matter in which that lawyer, or a firm with which the lawyer was associated, had previously represented a client whose interests are materially adverse to that person and about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter unless:

(1) the disqualified lawyer is screened from any participation in the matter and is apportioned no part of the fee therefrom; and

(2) written notice is promptly given to the appropriate client to enable it to ascertain compliance with the provisions of this rule.

(c) When a lawyer has terminated an association with a firm, the firm is not prohibited from thereafter representing a person with interests materially adverse to those of a client represented by the formerly associated lawyer and not currently represented by the firm, unless:

(1) the matter is the same or substantially related to that in which the formerly associated lawyer represented the client; and

(2) any lawyer remaining in the firm has information protected by Rules 1.6 and 1.9(c) that is material to the matter.

(d) A disqualification prescribed by this Rule may be waived by the affected client under the conditions stated in Rule 1.7.

(e) While lawyers are associated in a firm, a prohibition in paragraphs (a) through (i) of Rule 1.8 that applies to any one of them shall apply to all of them.

(f) The disqualification of lawyers in a firm with former or current government lawyers is governed by Rule 1.11.

(g) The disqualification of lawyers in a firm with a former judge, arbitrator, mediator or other third-party neutral is governed by Rule 1.12.

(h) Where a lawyer in a firm is disqualified from a matter due to consultation with a prospective client pursuant to Rule 1.18(b) and (c), disqualification of other lawyers in the same firm is governed by Rule 1.18(d).

(i) The disqualification of a lawyer when another lawyer in the lawyer's firm is likely to be called as a witness is governed by Rule 3.7.

Comment:

Definition of "Firm"

[1] For the purposes of the Rules of Professional Conduct, the term ''firm'' denotes lawyers in law partnership, professional corporation, sole proprietorship or other association authorized to practice law; or lawyers employed in a legal services organization or in the legal department of a corporation or other organization. See Rule 1.0(c). Whether two or more lawyers constitute a firm within this definition depends on specific facts. See Rule 1.0, Comments [2]-[4].

Principles of Imputed Disqualification

[2] The rule of imputed disqualification stated in paragraph (a) gives effect to the principle of loyalty to the client as it applies to lawyers who practice in a law firm. Such situations can be considered from the premise that a firm of lawyers is essentially one lawyer for purposes of the rules governing loyalty to the client, or from the premise that each lawyer is vicariously bound by the obligation of loyalty owed by each lawyer with whom the lawyer is associated. Paragraph (a) operates only among the lawyers currently associated in a firm. When a lawyer moves from one firm to another, the situation is governed by paragraphs (b) and (c).

[3] The rule in paragraph (a) does not prohibit representation where neither questions of client loyalty nor protection of confidential information are presented. Where one lawyer in a firm could not effectively represent a given client because of strong political beliefs, for example, but that lawyer will do no work on the case and the personal beliefs of the lawyer will not materially limit the representation by others in the firm, the firm should not be disqualified. On the other hand, if an opposing party in a case were owned by a lawyer in the law firm, and others in the firm would be materially limited in pursuing the matter because of loyalty to that lawyer, the personal disqualification of the lawyer would be imputed to all others in the firm.

[4] The rule in paragraph (a) also does not prohibit representation by others in the law firm where the person prohibited from involvement in a matter is a nonlawyer, such as a paralegal or legal secretary. Nor does paragraph (a) prohibit representation if the lawyer is prohibited from acting because of events before the person became a lawyer, for example, work that the person did while a law student. Such persons, however, ordinarily must be screened from any personal participation in the matter to avoid communication to others in the firm of confidential information that both the nonlawyers and the firm have a legal duty to protect. See Rules 1.0(k) and 5.3.

[5] Rule 1.10(c) operates to permit a law firm, under certain circumstances, to represent a person with interests directly adverse to those of a client represented by a lawyer who formerly was associated with the firm. The Rule applies regardless of when the formerly associated lawyer represented the client. However, the law firm may not represent a person with interests adverse to those of a present client of the firm, which would violate Rule 1.7. Moreover, the firm may not represent the person where the matter is the same or substantially related to that in which the formerly associated lawyer represented the client and any other lawyer currently in the firm has material information protected by Rules 1.6 and 1.9(c).

[6] Rule 1.10(d) removes imputation with the informed consent of the affected client or former client under the conditions stated in Rule 1.7. The conditions stated in Rule 1.7 require the lawyer to determine that the representation is not prohibited by Rule 1.7(b) and that each affected client or former client has given informed consent to the representation. In some cases, the risk may be so severe that the conflict may not be cured by client consent. For a discussion of the effectiveness of client waivers of conflicts that might arise in the future, see Rule 1.7, Comment [22]. For a definition of informed consent, see Rule 1.0(e).

[7] Where a lawyer has joined a private firm after having represented the government, imputation is governed by Rule 1.11(b) and (c), not this Rule. Under Rule 1.11(d), where a lawyer represents the government after having served–clients in private practice, nongovernmental employment or in another government agency, former-client conflicts are not imputed to government lawyers associated with the individually disqualified lawyer.

[8] Where a lawyer is prohibited from engaging in certain transactions under Rule 1.8, paragraph (k) of that Rule, and not this Rule, determines whether that prohibition also applies to other lawyers associated in a firm with the personally prohibited lawyer.

[9] The disqualification of lawyers in a firm with a former judge, arbitrator, mediator or other third-party neutral is governed by Rule 1.12.

[10] Where a lawyer is disqualified from a matter as a result of a consultation with a prospective client pursuant to Rule 1.18(b) and (c), disqualification of the other lawyers in the firm is governed by Rule 1.18(d).

[11] The disqualification of a lawyer when another lawyer in the lawyer's firm is likely to be called as a witness is governed by Rule 3.7.

Rule 1.11 Special Conflicts of Interest for Former and Current Government Officers and Employees

(a) Except as law may otherwise expressly permit, a lawyer who has formerly served as a public officer or employee of the government:

(1) is subject to Rule 1.9(c); and,

(2) shall not otherwise represent a private client in connection with a matter in which the lawyer participated personally and substantially as a public officer or employee, unless the appropriate government agency gives its informed consent to the representation.

(b) When a lawyer is disqualified from representation under paragraph (a), no lawyer in a firm with which that lawyer is associated may knowingly undertake or continue representation in such a matter unless:

(1) the disqualified lawyer is screened from any participation in the matter and is apportioned no part of the fee therefrom; and,

(2) written notice is promptly given to the appropriate government agency to enable it to ascertain compliance with the provisions of this Rule.

(c) Except as law may otherwise expressly permit, a lawyer having information that the lawyer knows is confidential government information about a person acquired when the lawyer was a public officer or employee may not represent a private client whose interests are adverse to that person in a matter in which the information could be used to the material disadvantage of that person. As used in this Rule, the term

"confidential government information" means information that has been obtained under governmental authority and which, at the time this Rule is applied, the government is prohibited by law from disclosing to the public or has a legal privilege not to disclose and which is not otherwise available to the public. A firm with which that lawyer is associated may undertake or continue representation in the matter only if the disqualified lawyer is screened from any participation in the matter and is apportioned no part of the fee therefrom.

(d) Except as law may otherwise expressly permit, a lawyer currently serving as a public officer or employee:

(1) is subject to Rules 1.7 and 1.9; and,

(2) shall not:

(i) participate in a matter in which the lawyer participated personally and substantially while in private practice or nongovernmental employment, unless the appropriate government agency gives its informed consent; or

(ii) negotiate for private employment with any person who is involved as a party or as a lawyer for a party in a matter in which the lawyer is participating personally and substantially, except that a lawyer serving as a law clerk to a judge, other adjudicative officer or arbitrator may negotiate for private employment as permitted by Rule 1.12(b) and subject to the conditions stated in Rule 1.12(b).

(e) As used in this Rule, the term "matter" includes:

(1) any judicial or other proceeding, application, request for a ruling or other determination, contract, claim, controversy, investigation, charge, accusation, arrest or other particular matter involving a specific party or parties; and,

(2) any other matter covered by the conflict of interest rules of the appropriate government agency.

Comment:

[1] A lawyer who has served or is currently serving as a public officer or employee is personally subject to the Rules of Professional Conduct, including the prohibition against current conflicts of interests stated in Rule 1.7. In addition, such a lawyer may be subject to statutes and government regulations regarding conflict of interest. Such statutes and regulations may circumscribe the extent to which the government agency may give consent under this Rule. See Rule 1.0(e) for the definition of informed consent.

[2] Paragraphs (a)(1), (a)(2), and (d)(1) restate the obligations of an individual lawyer who has served or is currently serving as an officer or employee of the government toward a former government or private client. Rule 1.10 is not applicable to the conflicts of interest addressed by this Rule. Rather, paragraph (b) sets forth a special imputation rule for former government lawyers that provides for screening and notice. Because of the special problems raised by imputation within a government agency, paragraph (d) does not impute the conflicts of a lawyer currently serving as an officer or employee of the government to other associated government officers or employees, although ordinarily it will be prudent to screen such lawyers.

[3] Paragraphs (c) and (d)(2) apply regardless of whether a lawyer is adverse to a former client and are thus designed not only to protect the former client, but also to prevent a lawyer from exploiting public office for the advantage of another client. For example, a lawyer who has pursued a claim on behalf of the government may not pursue the same claim on behalf of a later private client after the lawyer has left government service, except when authorized to do so by the government agency under paragraph (a)(2). Similarly, a lawyer who has pursued a claim on behalf of a private client may not pursue the claim on behalf of the government, except when authorized to do so by paragraph (d). As with paragraphs (a)(1) and (d)(1), Rule 1.10 is not applicable to the conflicts of interest addressed by these paragraphs.

[4] This Rule represents a balancing of interests. On the one hand, where the successive clients are a government agency and another client, public or private, the risk exists that power or discretion vested in that agency might be for the special benefit of the other client. A lawyer should not be in a position where benefit to the other client might affect performance of the lawyer's professional functions on behalf of the

government. Also, unfair advantage could accrue to the private client by reason of access to confidential government information about the client's adversary obtainable only through the lawyer's government service. On the other hand, the rules governing lawyers presently or formerly employed by a government agency should not be so restrictive as to inhibit transfer of employment to and from the government. The government has a legitimate need to attract qualified lawyers as well as to maintain high ethical standards. Thus, a former government lawyer is disqualified only from particular matters in which the lawyer participated personally and substantially. The provisions for screening in paragraph (b) are necessary to prevent the disqualification rule from imposing too severe a deterrent against entering public service. The limitation of disqualification in paragraphs (a)(2) and (d)(2) to matters involving a specific party or parties, rather than extending disqualification to all substantive issues on which the lawyer worked, serves a similar function.

[5] When a lawyer has been employed by one government agency and then moves to a second government agency, it may be appropriate to treat that second agency as another client for purposes of this Rule, as when a lawyer is employed by a city and subsequently is employed by a federal agency. However, because the conflict of interest is governed by paragraph (d), the latter agency is not required to screen the lawyer as paragraph (b) requires a law firm to do. The question of whether two government agencies should be regarded as the same or different clients for conflict of interest purposes is beyond the scope of these Rules. See Rule 1.13 Comment [6].

[6] Paragraphs (b) and (c) contemplate a screening arrangement. See Rule 1.0(k) (requirements for screening procedures). These paragraphs do not prohibit a lawyer from receiving a salary or distribution of firm profits established by prior independent agreement, but that lawyer may not receive compensation directly relating the attorney's compensation to the fee in the matter in which the lawyer is disqualified.

[7] Notice, including a description of the screened lawyer's prior representation and of the screening procedures employed, generally should be given as soon as practicable after the need for screening becomes apparent.

[8] Paragraph (c) operates only when the lawyer in question has knowledge of the information, which means actual knowledge; it does not operate with respect to information that merely could be imputed to the lawyer.

[9] Paragraphs (a) and (d) do not prohibit a lawyer from jointly representing a private party and a government agency when doing so is permitted by Rule 1.7 and is not otherwise prohibited by law.

[10] For purposes of paragraph (e) of this Rule, a "matter" may continue in another form. In determining whether two particular matters are the same, the lawyer should consider the extent to which the matters involve the same basic facts, the same or related parties, and the time elapsed.

Rule 1.12 Former Judge, Arbitrator, Mediator Or Other Third-Party Neutral

(a) Except as stated in paragraph (d), a lawyer shall not represent anyone in connection with a matter in which the lawyer participated personally and substantially as a judge or other adjudicative officer, third-party neutral (including arbitrator or mediator) or law clerk to such a person, unless all parties to the proceeding give informed consent.

(b) A lawyer shall not negotiate for employment with any person who is involved as a party or as lawyer for a party in which the lawyer is participating personally and substantially as a judge or other adjudicative officer, or third-party neutral. A lawyer serving as a law clerk to a judge, other adjudicative officer or third-party neutral may negotiate for employment with a party or lawyer involved in a matter in which the clerk is participating personally and substantially, but only after the lawyer has notified the judge, other adjudicative officer or third-party neutral.

(c) If a lawyer is disqualified by paragraph (a), no lawyer in a firm with which the lawyer is associated may knowingly undertake or continue representation in the matter unless:

(1) the disqualified lawyer is screened from any participation in the matter and is apportioned no part of the fee therefrom; and

(2) written notice is promptly given to the parties and any appropriate tribunal to enable them to ascertain compliance with the provisions of this Rule.

(d) An arbitrator selected as a partisan of a party in a multi-member arbitration panel is not prohibited from subsequently representing that party.

Comment:

[1] This Rule generally parallels Rule 1.11. The term "personally and substantially" signifies that a judge who was a member of a multi-member court, and thereafter left judicial office to practice law, is not prohibited from representing a client in a matter pending in the court, but in which the former judge did not participate. So also the fact that the former judge exercised administrative responsibility in a court does not prevent the former judge from acting as a lawyer in a matter where the judge had previously exercised remote or incidental administrative responsibility that did not affect the merits. Compare the Comment to Rule 1.11. The term "adjudicative officer" includes such officials as judges pro tempore, referees, special masters, hearing officers and other judicial officers, and also lawyers who serve as part-time judges. Compliance Canons A(2), B(2), and C of the Model Code of Judicial Conduct provide that a part-time judge, judge pro tempore or retired judge recalled to active service, may not "act as a lawyer in any proceeding in which he served as a judge or in any other proceeding relating thereto." Although phrased differently from this Rule, those Rules correspond in meaning.

[2] Like former judges, lawyers who have served as arbitrators, mediators, or other third-party neutrals may be asked to represent a client in a matter in which the lawyer participated personally and substantially. This Rule forbids such representation unless all of the parties give their informed consent. See Rule 1.0(e). Other law or codes of ethics governing third-party neutrals may impose more stringent standards of personal or imputed disqualification. See Rule 2.4.

[3] Although lawyers who serve as third-party neutrals do not have information concerning the parties that is protected under Rule 1.6, they typically owe the parties an obligation of confidentiality under the law or codes of ethics governing third-party neutrals. Thus, paragraph (c) provides that conflicts of the personally disqualified lawyer will be imputed to other lawyers in a law firm unless the conditions of this paragraph are met.

[4] Requirements for screening procedures are stated in Rule 1.0(k). Paragraph (c)(1) does not prohibit the screened lawyer from receiving a salary or partnership share established by prior independent agreement, but that lawyer may not receive compensation directly related to the matter in which the lawyer is disqualified.

[5] Notice, including a description of the screened lawyer's prior representation and of the screening procedures employed, generally should be given as soon as practicable after the need for screening becomes apparent. Notice must be given to the parties as well as to the appropriate tribunal.

Rule 1.13 Organization as Client

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, the lawyer shall proceed as is reasonably necessary in the best interest of the organization. In determining how to proceed, the lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyer's representation, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters and any other relevant considerations. Any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization. Such measures may include among others:

(1) asking for reconsideration of the matter;

(2) advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization; and,

(3) referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act on behalf of the organization as determined by applicable law.

(c) If, despite the lawyer's efforts in accordance with paragraph (b), the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly a violation of law and is likely to result in substantial injury to the organization, the lawyer may resign in accordance with Rule 1.16.

(d) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

(e) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

Comment:

The Entity as the Client

[1] An organizational client is a legal entity, but it cannot act except through its officers, directors, employees, shareholders and other constituents. Officers, directors, employees and shareholders are the constituents of the corporate organizational client. The duties defined in this Comment apply equally to unincorporated associations. "Other constituents" as used in this Comment means the positions equivalent to officers, directors, employees and shareholders held by persons acting for organizational clients that are not corporations.

[2] When one of the constituents of an organizational client communicates with the organization's lawyer in that person's organizational capacity, the communication is protected by Rule 1.6. Thus, by way of example, if an organizational client requests its lawyer to investigate allegations of wrongdoing, interviews made in the course of that investigation between the lawyer and the client's employees or other constituents are covered by Rule 1.6. This does not mean, however, that constituents of an organizational client are the clients of the lawyer. The lawyer may not disclose to such constituents information relating to the representation except for disclosures explicitly or impliedly authorized by the organizational client in order to carry out the representation or as otherwise permitted by Rule 1.6.

[3] When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful. Decisions concerning policy and operations, including ones entailing serious risk, are not as such in the lawyer's province. However, different considerations arise when the lawyer knows that the organization may be substantially injured by action of a constituent that is in violation of law. In such a circumstance, it may be reasonably necessary for the lawyer to ask the constituent to reconsider the matter. If that fails, or if the matter is of sufficient seriousness and importance to the organization, it may be reasonably necessary for the lawyer to take steps to have the matter reviewed by a higher authority in the organization. Clear justification should exist for seeking review over the head of the constituent normally responsible for it. The stated policy of the organization may define circumstances and prescribe channels for such review, and a lawyer should encourage the formulation of such a policy. Even in the absence of organization policy, however, the lawyer may have an obligation to refer a matter to higher authority, depending on the seriousness of the matter and whether the constituent in question has apparent motives to act at variance with the organization's interest. Review by the chief executive officer or by the board of directors may be required when the matter is of importance commensurate with their authority. At some point it may be useful or essential to obtain an independent legal opinion.

[4] The organization's highest authority to whom a matter may be referred ordinarily will be the board of directors or similar governing body. However, applicable law may prescribe that under certain conditions the highest authority reposes elsewhere, for example, in the independent directors of a corporation.

Relation to Other Rules

[5] The authority and responsibility provided in this Rule are concurrent with the authority and responsibility provided in other Rules. In particular, this Rule does not limit or expand the lawyer's responsibility under Rule 1.6, 1.8, 1.16, 3.3, or 4.1. If the lawyer's services are being used by an organization to further a crime or fraud by the organization, Rule 1.2(d) can be applicable.

Government Agency

[6] The duty defined in this Rule applies to governmental organizations. Defining precisely the identity of the client and prescribing the resulting obligations of such lawyers may be more difficult in the government context and is a matter beyond the scope of these Rules. See Scope [17]. Although in some circumstances the client may be a specific agency, it may also be a branch of government, such as the executive branch, or the government as a whole. For example, if the action or failure to act involves the head of a bureau, either the department of which the bureau is a part or the relevant branch of government may be the client for purposes of this Rule. Moreover, in a matter involving the conduct of government officials, a government lawyer may have authority under applicable law to question such conduct more extensively than that of a lawyer for a private organization in similar circumstances. Thus, when the client is a governmental organization, a different balance may be appropriate between maintaining confidentiality and assuring that the wrongful act is prevented or rectified, for public business is involved. In addition, duties of lawyers employed by the government or lawyers in military service may be defined by statutes and regulation. This Rule does not limit that authority. See Scope.

Clarifying the Lawyer's Role

[7] There are times when the organization's interest may be or become adverse to those of one or more of its constituents. In such circumstances the lawyer should advise any constituent, whose interest the lawyer finds adverse to that of the organization, of the conflict or potential conflict of interest, that the lawyer cannot represent such constituent, and that such person may wish to obtain independent representation. Care must be taken to assure that the individual understands that, when there is such adversity of interest, the lawyer for the organization cannot provide legal representation for that constituent individual, and that discussions between the lawyer for the organization and the individual may not be privileged.

[8] Whether such a warning should be given by the lawyer for the organization to any constituent individual may turn on the facts of each case.

Dual Representation

[9] Paragraph (e) recognizes that a lawyer for an organization may also represent a principal officer or major shareholder.

Derivative Actions

[10] Under generally prevailing law, the shareholders or members of a corporation may bring suit to compel the directors to perform their legal obligations in the supervision of the organization. Members of unincorporated associations have essentially the same right. Such an action may be brought nominally by the organization, but usually is, in fact, a legal controversy over management of the organization.

[11] The question can arise whether counsel for the organization may defend such an action. The proposition that the organization is the lawyer's client does not alone resolve the issue. Most derivative actions are a normal incident of an organization's affairs, to be defended by the organization's lawyer like any other suit. However, if the claim involves serious charges of wrongdoing by those in control of the organization, a conflict may arise between the lawyer's duty to the organization and the lawyer's relationship with the board. In those circumstances, Rule 1.7 governs who should represent the directors and the organization.

Rule 1.14 Client with Diminished Capacity

(a) When a client's capacity to make adequately considered decisions in connection with a representation is diminished, whether because of minority, mental impairment or for some other reason, the lawyer shall, as far as reasonably possible, maintain a normal client-lawyer relationship with the client.

(b) When the lawyer reasonably believes that the client has diminished capacity, is at risk of substantial physical, financial or other harm unless action is taken and cannot adequately act in the client's own interest, the lawyer may take reasonably necessary protective action, including consulting with individuals or entities that have the ability to take action to protect the client and, in appropriate cases, seeking the appointment of a guardian ad litem, conservator or guardian.

(c) Information relating to the representation of a client with diminished capacity is protected by Rule 1.6. When taking protective action pursuant to paragraph (b), the lawyer is impliedly authorized under Rule 1.6(a) to reveal information about the client, but only to the extent reasonably necessary to protect the client's interests.

Comment:

[1] The normal client-lawyer relationship is based on the assumption that the client, when properly advised and assisted, is capable of making decisions about important matters. When the client is a minor or suffers from a diminished mental capacity, however, maintaining the ordinary client-lawyer relationship may not be possible in all respects. In particular, a severely incapacitated person may have no power to make legally binding decisions. Nevertheless, a client with diminished capacity often has the ability to understand, deliberate upon, and reach conclusions about matters affecting the client's own well-being. For example, children as young as five or six years of age, and certainly those of ten or twelve, are regarded as having opinions that are entitled to weight in legal proceedings concerning their custody. So also, it is recognized that some persons of advanced age can be quite capable of handling routine financial matters while needing special legal protection concerning major transactions.

[2] The fact that a client suffers a diminished capacity does not diminish the lawyer's obligation to treat the client with attention and respect. Even if the person has a legal representative, the lawyer should as far as possible accord the represented person the status of client, particularly in maintaining communication.

[3] The client may wish to have family members or other persons participate in discussions with the lawyer. When necessary to assist in the representation, the presence of such persons generally does not affect the applicability of the attorney-client evidentiary privilege. Nevertheless, the lawyer must keep the client's interests foremost and, except for protective action authorized under paragraph (b), must look to the client, and not family members, to make decisions on the client's behalf.

[4] If a legal representative has already been appointed for the client, the lawyer should ordinarily look to the representative for decisions on behalf of the client. In matters involving a minor, whether the lawyer should look to the parents as natural guardians may depend on the type of proceeding or matter in which the lawyer is representing the minor. If the lawyer represents the guardian as distinct from the ward, and is aware that the guardian is acting adversely to the ward's interest, the lawyer may have an obligation to prevent or rectify the guardian's misconduct. See Rule 1.2(d).

Taking Protective Action

[5] If a lawyer reasonably believes that a client is at risk of substantial physical, financial or other harm unless action is taken, and that a normal client-lawyer relationship cannot be maintained as provided in paragraph (a) because the client lacks sufficient capacity to communicate or to make adequately considered decisions in connection with the representation, then paragraph (b) permits the lawyer to take protective measures deemed necessary. Such measures could include: consulting with family members, using a reconsideration period to permit clarification or improvement of circumstances, using voluntary surrogate decision-making tools such as durable powers of attorney or consulting with support groups, professional services, adult-protective agencies or other individuals or entities that have the ability to protect the client. In taking any protective action, the lawyer should be guided by such factors as the wishes and values of the client to the extent known, the client's best interests and the goals of intruding into the client's decision-making autonomy to the least extent feasible, maximizing client capacities and respecting the client's family and social connections.

[6] In determining the extent of the client's diminished capacity, the lawyer should consider and balance such factors as: the client's ability to articulate reasoning leading to a decision, variability of state of mind and ability to appreciate consequences of a decision; the substantive fairness of a decision; and the consistency of a decision with the known long-term commitments and values of the client. In appropriate circumstances, the lawyer may seek guidance from an appropriate diagnostician.

[7] If a legal representative has not been appointed, the lawyer should consider whether appointment of a guardian ad litem, conservator or guardian is necessary to protect the client's interests. Thus, if a client with diminished capacity has substantial property that should be sold for the client's benefit, effective completion of the transaction may require appointment of a legal representative. In addition, rules of procedure in litigation sometimes provide that minors or persons with diminished capacity must be represented by a guardian or next friend if they do not have a general guardian. In many circumstances, however, appointment of a legal representative may be more expensive or traumatic for the client than circumstances in fact require. Evaluation of such circumstances is a matter entrusted to the professional judgment of the lawyer. In considering alternatives, however, the lawyer should be aware of any law that requires the lawyer to advocate the least restrictive action on behalf of the client.

Disclosure of the Client's Condition

[8] Disclosure of the client's diminished capacity could adversely affect the client's interests. For example, raising the question of diminished capacity could, in some circumstances, lead to proceedings for involuntary commitment. Information relating to the representation is protected by Rule 1.6. Therefore, unless authorized to do so, the lawyer may not disclose such information. When taking protective action pursuant to paragraph (b), the lawyer is impliedly authorized to make the necessary disclosures, even when the client directs the lawyer to the contrary. Nevertheless, given the risks of disclosure, paragraph (c) limits what the lawyer may disclose in consulting with other individuals or entities or seeking the appointment of a legal representative. At the very least, the lawyer should determine whether it is likely that the person or entity consulted with will act adversely to the client's interests before discussing matters related to the client. The lawyer's position in such cases is an unavoidably difficult one.

Emergency Legal Assistance

[9] In an emergency where the health, safety or a financial interest of a person with seriously diminished capacity is threatened with imminent and irreparable harm, a lawyer may take legal action on behalf of such a person even though the person is unable to establish a client-lawyer relationship or to make or express considered judgments about the matter, when the person or another acting in good faith on that person's behalf has consulted with the lawyer. Even in such an emergency, however, the lawyer should not act unless the lawyer reasonably believes that the person has no other lawyer, agent or other representative available. The lawyer should take legal action on behalf of the person only to the extent reasonably necessary to maintain the status quo or otherwise avoid imminent and irreparable harm. A lawyer who undertakes to represent a person in such an exigent situation has the same duties under these Rules as the lawyer would with respect to a client.

[10] A lawyer who acts on behalf of a person with seriously diminished capacity in an emergency should keep the confidences of the person as if dealing with a client, disclosing them only to the extent necessary to accomplish the intended protective action. The lawyer should disclose to any tribunal involved and to any other counsel involved the nature of his or her relationship with the person. The lawyer should take steps to regularize the relationship or implement other protective solutions as soon as possible. Normally, a lawyer would not seek compensation for such emergency actions taken.

Rule 1.15 Safekeeping Property

(a) The following definitions are applicable to Rule 1.15:

(1) *Eligible Institution*. An Eligible Institution is a Financial Institution which has been approved as a depository of Trust Accounts pursuant to Pa.R.D.E. 221(h).

(2) *Fiduciary.* A Fiduciary is a lawyer acting as a personal representative, guardian, conservator, receiver, trustee, agent under a durable power of attorney, or other similar position.

(3) *Fiduciary Funds*. Fiduciary Funds are Rule 1.15 Funds which the lawyer holds as a Fiduciary. Fiduciary Funds may be either Qualified Funds or Nonqualified Funds.

(4) *Financial Institution*. A Financial Institution is an entity which is authorized by federal or state law and licensed to do business in the Commonwealth of Pennsylvania as one of the following: a bank, bank and trust company, trust company, credit union, savings bank, savings and loan association, or foreign banking corporation, the deposits of which are insured by an agency of the federal government, or as an investment adviser registered under the Investment Advisers Act of 1940 or with the Pennsylvania Securities Commission, an investment company registered under the Investment Company Act of 1940, or a broker dealer registered under the Securities Exchange Act of 1934.

(5) *Interest On Lawyer Trust Account* (*IOLTA) Account.* An IOLTA Account is an income producing Trust Account from which funds may be withdrawn upon request as soon as permitted by law. Qualified Funds are to be held or deposited in an IOLTA Account.

(6) *IOLTA Board.* The IOLTA Board is the Pennsylvania Interest On Lawyers Trust Account Board.

(7) *Non-IOLTA Account.* A Non-IOLTA Account is an income producing Trust Account from which funds may be withdrawn upon request as soon as permitted by law in which a lawyer deposits Rule 1.15 Funds. Only Nonqualified Funds are to be held or deposited in a Non-IOLTA Account. A Non-IOLTA Account shall be established only as:

(i) a separate client Trust Account for the particular client or matter on which the net income will be paid to the client or third person; or

(ii) a pooled client Trust Account with sub-accounting by the Eligible Institution or by the lawyer, which will provide for computation of net income earned by each client's or third person's funds and the payment thereof to the client or third person.

(8) *Nonqualified Funds*. Nonqualified Funds are Rule 1.15 Funds, whether cash, check, money order, or other negotiable instrument*,* which are not Qualified Funds.

(9) *Qualified Funds.* Qualified Funds are Rule 1.15 Funds which are nominal in amount or are reasonably expected to be held for such a short period of time that sufficient income will not be generated to justify the expense of administering a segregated account.

(10) *Rule 1.15 Funds*. Rule 1.15 Funds are funds which the lawyer receives from a client or third person in connection with a client-lawyer relationship, or as an escrow agent, settlement agent or representative payee, or as a Fiduciary, or receives as an agent, having been designated as such by a client or having been so selected as a result of a client-lawyer relationship or the lawyer's status as such. When the term "property" appears with "Rule 1.15 Funds," it means property of a client or third person which the lawyer receives in any of the foregoing capacities.

(11) *Trust Account*. A Trust Account is an account in an Eligible Institution in which a lawyer holds Rule 1.15 Funds. A Trust Account must be maintained either as an IOLTA Account or as a Non-IOLTA Account.

(b) A lawyer shall hold all Rule 1.15 Funds and property separate from the lawyer's own property. Such property shall be identified and appropriately safeguarded.

(c) *Required records.* Complete records of the receipt, maintenance, and disposition of Rule 1.15 Funds and property shall be preserved for a period of five years after termination of the client-lawyer or Fiduciary relationship or after distribution or disposition of the property, whichever is later. A lawyer shall maintain the writing required by Rule 1.5(b) (relating to the requirement of a writing communicating the basis or rate of the fee) and the records identified in Rule 1.5(c) (relating to the requirement of a written fee agreement and distribution statement in a contingent fee matter). A lawyer shall also maintain the following books and records for each Trust Account and for any other account in which Fiduciary Funds are held pursuant to Rule 1.15(l):

(1) all transaction records provided to the lawyer by the Financial Institution or other investment entity, such as periodic statements, cancelled checks in whatever form, deposited items, and records of electronic transactions; and

(2) check register or separately maintained ledger, which shall include the payee, date, purpose and amount of each check, withdrawal and transfer, the payor, date, and amount of each deposit, and the matter involved for each transaction; provided, however, that where an account is used to hold funds of more than one client, a lawyer shall also maintain an individual ledger for each trust client, showing the source, amount and nature of all funds received from or on behalf of the client, the description and amounts of charges or withdrawals, the names of all persons or entities to whom such funds were disbursed, and the dates of all deposits, transfers, withdrawals and disbursements.

(3) The records required by this Rule may be maintained in hard copy form or by electronic, photographic, or other media provided that the records otherwise comply with this Rule and that printed copies can be produced. Whatever method is used to maintain required records must have a backup so that the records are secure and always available. If records are kept only in electronic form, then such records shall be backed up on a separate electronic storage device at least at the end of any day on which entries have been entered into the records. These records shall be readily accessible to the lawyer and available for production to the Pennsylvania Lawyers Fund for Client Security or the Office of Disciplinary Counsel in a timely manner upon a request or demand by either agency made pursuant to the Pennsylvania Rules of Disciplinary Enforcement, the Disciplinary Board Rules, the Pennsylvania Lawyers Fund for Client Security Board Rules and Regulations, agency practice, or subpoena.

(4) A regular trial balance of the individual client trust ledgers shall be maintained. The total of the trial balance must agree with the control figure computed by taking the beginning balance, adding the total of monies received in trust for the client, and deducting the total of all moneys disbursed. On a monthly basis, a lawyer shall conduct a reconciliation for each fiduciary account. The reconciliation is not complete if the reconciled total cash balance does not agree with the total of the client balance listing. A lawyer shall preserve for a period of five years copies of all records and computations sufficient to prove compliance with this requirement.

(d) Upon receiving Rule 1.15 Funds or property which are not Fiduciary Funds or property, a lawyer shall promptly notify the client or third person, consistent with the requirements of applicable law. Notification of receipt of Fiduciary Funds or property to clients or other persons with a beneficial interest in such Fiduciary Funds or property shall continue to be governed by the law, procedure and rules governing the requirements of confidentiality and notice applicable to the Fiduciary entrustment.

(e) Except as stated in this Rule or otherwise permitted by law or by agreement with the client or third person, a lawyer shall promptly deliver to the client or third person any property, including but not limited to Rule 1.15 Funds, that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding the property; Provided, however, that the delivery, accounting, and disclosure of Fiduciary Funds or property shall continue to be governed by the law, procedure and rules governing the requirements of Fiduciary administration, confidentiality, notice and accounting applicable to the Fiduciary entrustment.

(f) When in possession of funds or property in which two or more persons, one of whom may be the lawyer, claim an interest, the funds or property shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the funds or property, including Rule 1.15 Funds, as to which the interests are not in dispute.

(g) The responsibility for identifying an account as a Trust Account shall be that of the lawyer in whose name the account is held. Only a lawyer admitted to practice law in this jurisdiction or a person under the direct supervision of the lawyer shall be an authorized signatory or authorize transfers from a Trust Account or any other account in which Fiduciary Funds are held pursuant to Rule 1.15(l).

(h) A lawyer shall not deposit the lawyer's own funds in a Trust Account except for the sole purpose of paying service charges on that account, and only in an amount necessary for that purpose.

(i) A lawyer shall deposit into a Trust Account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred, unless the client gives informed consent, confirmed in writing, to the handling of fees and expenses in a different manner.

(j) At all times while a lawyer holds Rule 1.15 Funds, the lawyer shall also maintain another account that is not used to hold such funds.

(k) All Nonqualified Funds which are not Fiduciary Funds shall be placed in a Non-IOLTA Account or in another investment vehicle specifically agreed upon by the lawyer and the client or third person which owns the funds.

(l) All Fiduciary Funds shall be placed in a Trust Account (which, if the Fiduciary Funds are also Qualified Funds, must be an IOLTA Account) or in another investment or account which is authorized by the law applicable to the entrustment or the terms of the instrument governing the Fiduciary Funds.

(m) All Qualified Funds which are not Fiduciary Funds shall be placed in an IOLTA Account.

(n) A lawyer shall be exempt from the requirement that all Qualified Funds be placed in an IOLTA Account only upon exemption requested and granted by the IOLTA Board. If an exemption is granted, the lawyer must hold Qualified Funds in a Trust Account which is not income producing. Exemptions shall be granted if:

(1) the nature of the lawyer's practice does not require the routine maintenance of a Trust Account in Pennsylvania;

(2) compliance with this paragraph would work an undue hardship on the lawyer or would be extremely impractical, based either on the geographical distance between the lawyer's principal office and the closest Eligible Institution or on other compelling and necessitous factors; or

(3) the lawyer's historical annual Trust Account experience, based on information from the Eligible Institution in which the lawyer deposits funds, demonstrates that the service charges on the account would significantly and routinely exceed any income generated.

(o) An account shall not be considered an IOLTA Account unless the Eligible Institution at which the account is maintained shall:

(1) Remit at least quarterly any income earned on the account to the IOLTA Board;

(2) Transmit to the IOLTA Board with each remittance and to the lawyer who maintains the IOLTA Account a statement showing at least the name of the account, service charges or fees deducted, if any, the amount of income remitted from the account, and the average daily balance, if available; and

(3) Pay a rate of interest or dividends no less than the highest interest rate or dividend generally available from the Eligible Institution to its non-IOLTA customers when the IOLTA Account meets the same minimum balance or other eligibility qualifications, and comply with the Regulations of the IOLTA Board with respect to service charges, if any.

(p) A lawyer shall not be liable in damages or held to have breached any fiduciary duty or responsibility because monies are deposited in an IOLTA Account pursuant to the lawyer's judgment in good faith that the monies deposited were Qualified Funds.

(q) There is hereby created the Pennsylvania Interest On Lawyers Trust Account Board, which shall administer the IOLTA program. The IOLTA Board shall consist of nine members who shall be appointed by the Supreme Court. Two of the appointments shall be made from a list provided to the Supreme Court by the Pennsylvania Bar Association in accordance with its own rules and regulations. With respect to these two appointments, the Pennsylvania Bar Association shall submit three names to the Supreme Court, from which the Court shall make its final selections. The term of each member shall be three years and no member shall be appointed for more than two consecutive three-year terms. The Supreme Court shall appoint a Chairperson. In order to administer the IOLTA program, the IOLTA Board shall promulgate rules and regulations consistent with this Rule for approval by the Supreme Court.

(r) The IOLTA Board shall comply with the following:

(1) The IOLTA Board shall prepare an annual audited statement of its financial affairs.

(2) The IOLTA Board shall submit to the Supreme Court for its approval a copy of its audited statement of financial affairs, clearly setting forth in detail all funds previously approved for disbursement under the IOLTA program and the IOLTA Board's proposed annual budget, designating the uses to which IOLTA Funds are recommended.

(3) Upon approval of the Supreme Court, the IOLTA Board shall distribute and/or expend IOLTA Funds.

(s) Income earned on IOLTA Accounts (IOLTA Funds) may be used only for the following purposes:

(1) delivery of civil legal assistance to the poor and disadvantaged in Pennsylvania by non-profit corporations described in section 501(c)(3) of the Internal Revenue Code of 1986, as amended;

(2) educational legal clinical programs and internships administered by law schools located in Pennsylvania;

(3) administration and development of the IOLTA program in Pennsylvania; and

(4) the administration of justice in Pennsylvania.

(t) The IOLTA Board shall hold the beneficial interest in IOLTA Funds. Monies received in the IOLTA program are not state or federal funds and are not subject to Article VI of the act of April 9, 1929 (P.L. 177, No. 175) known as The Administrative Code of 1929, or the act of June 29, 1976 (P.L. 469, No. 117).

(u) Every attorney who is required to pay an active annual assessment under Rule 219 of the Pennsylvania Rules of Disciplinary Enforcement (relating to annual registration of attorneys) shall pay an additional annual fee of $30.00 for use by the IOLTA Board. Such additional assessment shall be added to, and collected with and in the same manner as, the basic annual assessment. All amounts received pursuant to this subdivision shall be credited to the IOLTA Board.

(v) Unclaimed or Unidentifiable IOLTA Funds

(1) When a lawyer or law firm cannot, using reasonable efforts for a minimum of two (2) years, identify or locate the owner of funds in either its Pennsylvania IOLTA account or the Pennsylvania IOLTA account of a deceased lawyer whose estate is represented by the lawyer or law firm, it shall pay the funds to the Pennsylvania IOLTA Board. At the time such funds are remitted, the lawyer or law firm shall submit to the IOLTA Board the name and last known address of each person appearing from the lawyer's or law firm's records to be entitled to the funds, and the amount of unclaimed funds to which each owner is entitled, if known; the amount of any unidentifiable funds; and a description of the efforts undertaken to identify and locate the owner(s).

(2) If, after making a payment of unclaimed or unidentifiable funds to the Pennsylvania IOLTA Board, the lawyer or law firm identifies and locates the owner of funds paid, the IOLTA Board shall refund the sum to the lawyer or law firm. The lawyer or law firm shall submit to the IOLTA Board a verification attesting that the funds have been returned to the owner. The IOLTA Board shall review claims submitted by purported owners of funds when the lawyer or law firm that originally remitted the funds to the IOLTA Board is no longer available. The IOLTA Board shall maintain a sufficient reserve to pay all claims for such funds.

(3) Should the Pennsylvania Lawyers Fund for Client Security pay an award to a former client of a lawyer, law firm, or deceased lawyer who has remitted funds under this Rule to the IOLTA Board, the Pennsylvania Lawyers Fund for Client Security may pursue a reimbursement of such award from unclaimed funds remitted by the lawyer, law firm, or deceased lawyer to the IOLTA Board in which the former client held an ownership interest. In no event would a reimbursement to the Pennsylvania Lawyers Fund for Client Security exceed the amount of funds remitted to the IOLTA Board by the subject lawyer, law firm, or deceased lawyer.

(4) A lawyer shall not be liable in damages or held to have breached any fiduciary duty or responsibility as a result of his or her good faith adherence to the unclaimed or unidentifiable IOLTA fund requirements in this subsection.

Comment:

[1] A lawyer should hold property of others with the care required of a professional fiduciary. The obligations of a lawyer under this Rule apply when the lawyer has come into possession of property of clients or third persons because the lawyer is acting or has acted as a lawyer in a client-lawyer relationship, or when the lawyer is acting as a Fiduciary, or as an escrow agent, a settlement agent or a representative payee, or as an agent, having been designated as such by a client or having been so selected as a result of a client-lawyer relationship or the lawyer's status as such. Securities should be appropriately safeguarded. All property which is the property of clients or third persons, including prospective clients, must be kept separate from the lawyer's business and personal property and, if Rule 1.15 Funds, in one or more Trust Accounts, or, if a Fiduciary entrustment, in an investment or account authorized by applicable law or a governing instrument. The responsibility for identifying an account as a Trust Account shall be that of the lawyer in whose name the account is held. Whenever a lawyer holds Rule 1.15 Funds, the lawyer must maintain at least two accounts: one in which those funds are held and another in which the lawyer's own funds may be held.

[2] A lawyer should maintain on a current basis books and records in accordance with sound accounting practices consistently applied and comply with any recordkeeping rules established by law or court order, including those records identified in paragraph (c). With little exception, funds belonging to a client or third party must be deposited into a Trust Account as defined in paragraph (a)(11), and funds belonging to the lawyer must be deposited in a business operating account maintained pursuant to paragraph (j). Thus, unless the client gives informed consent, confirmed in writing, to a different manner of handling funds advanced by the client to cover fees and expenses, the lawyer must deposit those funds into a Trust Account pursuant to paragraph (i). If the lawyer pools such funds belonging to more than one client, under paragraph (c)(2) the lawyer must keep a ledger for each individual client, regularly recording all funds received from the client and their purpose, and all disbursements of earned fees and expenses incurred. As fees become earned, the lawyer must promptly transfer those funds to the operating account. If the lawyer pools client funds after settlement or verdict in a single Trust Account, the lawyer must maintain a ledger of receipts and disbursements for each individual client, regularly recording the dates of each transaction, the identity of payors and payees, and the purpose of each disbursement, withdrawal or transfer of funds. The requirement of monthly reconciliations should deter situations where an attorney's Trust Account contains a shortfall for any significant period of time. Additionally, if a lawyer fails to maintain the records identified in paragraph (c) or to perform the required monthly reconciliations, later claims by the lawyer that a shortfall (i.e., misappropriation) resulted from negligence, even if credible, will necessarily be balanced against the lawyer's abdication of responsibility to comply with essential requirements associated with acting as a fiduciary and serving in a position of trust. The failure to maintain or timely produce the records required by paragraph (c) hampers rule-mandated or agency-promulgated investigative inquiries by the Pennsylvania Lawyers Fund for Client Security and the Office of Disciplinary Counsel and may serve as a basis for emergency temporary suspension of the lawyer's license to practice law. See Pa.R.D.E. 208(f)(1), 208(f)(5), 213(g)(2) and 221(g)(3).

[3] While normally it is impermissible to commingle the lawyer's own funds with Rule 1.15 Funds, paragraph (h) provides that it is permissible when necessary to pay service charges on that account. Accurate records must be kept regarding the funds.

[4] A lawyer's obligations with respect to funds of clients and third persons depend on the capacity in which the lawyer receives them, on whether they are Fiduciary Funds as defined in paragraph (a)(3) and on whether they are Nonqualified Funds or Qualified Funds as defined in paragraphs (a)(8) or (9) respectively. If the lawyer receives them in one of the capacities identified in paragraph (a)(10), the obligations in paragraphs (b) through (h), such as safeguarding, notification, and recordkeeping, apply. Nonqualified Funds other than Fiduciary Funds are to be placed in a Non-IOLTA Account, as defined in paragraph (a)(7), in an Eligible Institution, as defined in paragraph (a)(1), unless the client or third person specifically agrees to another investment vehicle for the benefit of the client or third person. Qualified Funds other than Fiduciary Funds must, subject to certain exceptions, be placed in an IOLTA Account defined in paragraph (a)(5).

[5] If the funds, whether Qualified Funds or Nonqualified Funds, are Fiduciary Funds, they may be placed in an investment or account authorized by the law applicable to the entrustment or authorized by the terms of the instrument governing the Fiduciary Funds. In such investment or account they shall be subject to the obligations of safeguarding, notification, and recordkeeping. This Rule is not intended to change the substantive law or procedural rules that govern Fiduciary Funds or property with the exception of the specific recordkeeping requirements, segregation of Fiduciary Funds or property, and where Fiduciary Funds are kept in an Eligible Institution, overdraft reporting pursuant to Pa.R.D.E. 221, to the extent that those requirements underscore or supplement the requirements regarding Fiduciary Funds or property. The goal of the amendments is to require all attorneys to keep appropriate records of entrusted funds, segregate such funds from the attorney's funds, account to those with an interest in the funds, and distribute the funds when due, and to permit the disciplinary system to respond when lawyers fail to comply with these standards.

[6] This Rule does not require a Fiduciary to liquidate entrusted investments or investments made in accordance with applicable law or a governing instrument or to transfer non-income producing fiduciary account balances to an IOLTA Account. This Rule does not prohibit a Fiduciary from making an investment in accordance with applicable law or a governing instrument. Funds which are controlled by a non-lawyer professional co-fiduciary shall not be considered to be Rule 1.15 Funds for the purposes of this Rule.

[7] Lawyers often receive funds from which the lawyer's fee will be paid. Unless the fee is non-refundable, it should be deposited to a Trust Account and drawn down as earned. The lawyer is not required to remit to the client funds that the lawyer reasonably believes represent fees owed. However, a lawyer may not hold funds to coerce a client into accepting the lawyer's contention. The disputed portion of the funds must be kept in a Trust Account and the lawyer should suggest means for prompt resolution of the dispute, such as arbitration. The undisputed portion of the funds shall be promptly distributed.

[8] Third parties may have lawful claims against specific funds or other property in a lawyer's custody such as a client's creditor who has a lien on funds recovered in a personal injury action. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client. In such cases, when the third party claim is not frivolous under applicable law, the lawyer must refuse to surrender the property to the client unless the claims are resolved. A lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party. When there are substantial grounds for dispute as to the person entitled to the funds, the lawyer may file an action to have a court resolve the dispute**.**

[9] Other applicable law may impose pertinent obligations upon a lawyer independent of and in addition to the obligations arising from this Rule. For example, a lawyer who receives funds as an escrow agent, a representative payee, or a Fiduciary remains subject to the law applicable to the entrustment, such as the Probate, Estates and Fiduciaries Code, Orphans' Court Rules, the Social Security Act, and to the terms of the governing instrument*.* If, during the final year of a Fiduciary entrustment, the lawyer who is serving as a Fiduciary reasonably expects that the funds cannot earn income for the client or third person in excess of the cost incurred to secure such income while the funds are held, the lawyer may, in the discretion of the lawyer, deposit the funds into the IOLTA Account of the lawyer, or may arrange to discontinue the payment of interest on the segregated Trust Account.

[10] A lawyer must participate in the Pennsylvania Lawyers Fund for Client Security established in Rule 503 of the Pennsylvania Rules of Disciplinary Enforcement. It is a means through the collective efforts of the bar to reimburse persons who have lost money or property as a result of dishonest conduct of a lawyer.

[11] Paragraphs (q) through (t) provide for the Interest on Lawyer Trust Account (IOLTA) program. There are further instructions relating to the IOLTA program in Rules 219 and 221 of the Pennsylvania Rules of Disciplinary Enforcement and in the Regulations of the Interest On Lawyers Trust Account Board, 204 Pa. Code, § 81.1 et seq., which are referred to as the IOLTA Regulations.

(12) For purposes of subsection (v), unidentifiable funds refers to funds accumulated in an IOLTA account that cannot be reasonably documented as belonging to a client, former client, third party, or the lawyer or law firm. Unclaimed funds refers to funds for which a client, former client, or third party appear to have an interest, but have not responded to the lawyer or law firm's reasonable efforts to encourage the client, former client, or third party to claim their rightful funds. A lawyer or law firm's reasonable efforts to identify the owner of funds include a review of transaction records, client ledgers, case files, and any other relevant fee records. Reasonable efforts to locate the owner of funds include periodic correspondence of the type contemplated by the lawyer or law firm's relationship with the client, former client, or third party. Should such correspondence prove unsuccessful, a lawyer or law firm's reasonable efforts include efforts similar to those

that would be undertaken when attempting to locate a person for service of process, such as examinations of local telephone directories, courthouse records, voter registration records, local tax records, motor vehicle records, or the use of consolidated online search services that access such records. Lawyers must maintain records of the disposition of unclaimed or unidentifiable funds and make such records available for production to the Pennsylvania Lawyers Fund for Client Security or the Office of Disciplinary Counsel in accordance with Pa. R.P.C. 1.15(c). The IOLTA Board shall make a standardized form with instructions available on the IOLTA Board's website or by request for use by lawyers submitting unclaimed or unidentifiable funds to the IOLTA Board. Conservators appointed pursuant to Pa.R.D.E. 321 should follow the procedure in Pa.R.D.E. 324(c)(1) for distributing unclaimed and unidentifiable funds.

Rule 1.16 Declining or Terminating Representation

(a) Except as stated in paragraph (c), a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if:

(1) the representation will result in violation of the Rules of Professional Conduct or other law;

(2) the lawyer's physical or mental condition materially impairs the lawyer's ability to represent the client; or,

(3) the lawyer is discharged.

(b) Except as stated in paragraph (c), a lawyer may withdraw from representing a client if:

(1) withdrawal can be accomplished without material adverse effect on the interests of the client;

(2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;

(3) the client has used the lawyer's services to perpetrate a crime or fraud;

(4) the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement;

(5) the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;

(6) the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or,

(7) other good cause for withdrawal exists.

(c) A lawyer must comply with applicable law requiring notice to or permission of a tribunal when terminating a representation. When ordered to do so by a tribunal, a lawyer shall continue representation notwithstanding good cause for terminating the representation.

(d) Upon termination of representation, a lawyer shall take steps to the extent reasonably practicable to protect a client's interests, such as giving reasonable notice to the client, allowing time for employment of other counsel, surrendering papers and property to which the client is entitled and refunding any advance payment of fee or expense that has not been earned or incurred. The lawyer may retain papers relating to the client to the extent permitted by other law.

Comment:

[1] A lawyer should not accept representation in a matter unless it can be performed competently, promptly, without improper conflict of interest and to completion. Ordinarily, a representation in a matter is

completed when the agreed-upon assistance has been concluded. See Rules 1.2(c) and 6.5. See also Rule 1.3, Comment [4].

Mandatory Withdrawal

[2] A lawyer ordinarily must decline or withdraw from representation if the client demands that the lawyer engage in conduct that is illegal or violates the Rules of Professional Conduct or other law. The lawyer is not obliged to decline or withdraw simply because the client suggests such a course of conduct; a client may make such a suggestion in the hope that a lawyer will not be constrained by a professional obligation.

[3] When a lawyer has been appointed to represent a client, withdrawal ordinarily requires approval of the appointing authority. See also Rule 6.2. Similarly, court approval or notice to the court is often required by applicable law before a lawyer withdraws from pending litigation. Difficulty may be encountered if withdrawal is based on the client's demand that the lawyer engage in unprofessional conduct. The court may request an explanation for the withdrawal, while the lawyer may be bound to keep confidential the facts that would constitute such an explanation. The lawyer's statement that professional considerations require termination of the representation ordinarily should be accepted as sufficient. Lawyers should be mindful of their obligations to both clients and the court under Rules 1.6 and 3.3.

Discharge

[4] A client has a right to discharge a lawyer at any time, with or without cause, subject to liability for payment for the lawyer's services. Where future dispute about the withdrawal may be anticipated, it may be advisable to prepare a written statement reciting the circumstances.

[5] Whether a client can discharge appointed counsel may depend on applicable law. A client seeking to do so should be given a full explanation of the consequences. These consequences may include a decision by the appointing authority that appointment of successor counsel is unjustified, thus requiring self-representation by the client.

[6] If the client has severely diminished capacity, the client may lack the legal capacity to discharge the lawyer, and in any event the discharge may be seriously adverse to the client's interests. The lawyer should make special effort to help the client consider the consequences and may take reasonably necessary protective action as provided in Rule 1.14.

Optional Withdrawal

[7] A lawyer may withdraw from representation in some circumstances. The lawyer has the option to withdraw if it can be accomplished without material adverse effect on the client's interests. Withdrawal is also justified if the client persists in a course of action that the lawyer reasonably believes is criminal or fraudulent, for a lawyer is not required to be associated with such conduct even if the lawyer does not further it. Withdrawal is also permitted if the lawyer's services were misused in the past even if that would materially prejudice the client. The lawyer may also withdraw where the client insists on taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement.

[8] A lawyer may withdraw if the client refuses to abide by the terms of an agreement relating to the representation, such as an agreement concerning fees or court costs or an agreement limiting the objectives of the representation.

Assisting the Client upon Withdrawal

[9] Even if the lawyer has been unfairly discharged by the client, a lawyer must take all reasonable steps to mitigate the consequences to the client. The lawyer may retain papers as security for a fee only to the extent permitted by law. See Rule 1.15.

Rule 1.17 Sale of Law Practice

A lawyer or law firm may, for consideration, sell or purchase a law practice, or an area of practice, including good will, if the following conditions are satisfied:

(a) The seller ceases to engage in the private practice of law, or in the area of practice that has been sold, in Pennsylvania; however, the seller is not prohibited from assisting the purchaser in the orderly transition of active client matters for a reasonable period after the closing without a fee.

(b) The seller sells the entire practice, or the entire area of practice, to one or more lawyers or law firms.

(c) The seller gives written notice to each of the seller's clients, which notice must include at a minimum:

(1) notice of the proposed transfer of the client's representation, including the identity and address of the purchaser;

(2) a statement that the client has the right to representation by the purchaser under the preexisting fee arrangements;

(3) a statement that the client has the right to retain other counsel or to take possession of the file; and

(4) a statement that the client's consent to the transfer of the representation will be presumed if the client does not take any action or does not otherwise object within 60 days of receipt of the notice.

If a client cannot be given notice, the representation of that client may be transferred to the purchaser only upon entry of an order so authorizing by a court having jurisdiction. The seller may disclose to the court in camera information relating to the representation only to the extent necessary to obtain an order authorizing the transfer of a file.

(d) The fees charged clients shall not be increased by reason of the sale. Existing agreements between the seller and the client concerning fees and the scope of work must be honored by the purchaser, unless the client gives informed consent confirmed in writing.

(e) The agreement of sale shall include a clear statement of the respective responsibilities of the parties to maintain and preserve the records and files of the seller's practice, including client files.

(f) In the case of a sale by reason of disability, if a proceeding under Rule 301 of the Pennsylvania Rules of Disciplinary Enforcement has not been commenced against the seller, the seller shall file the notice and request for transfer to voluntary inactive status, as of the date of the sale, pursuant to Rule 219(j) thereof.

(g) The sale shall not be effective as to any client for whom the proposed sale would create a conflict of interest for the purchaser or who cannot be represented by the purchaser because of other requirements of the Pennsylvania Rules of Professional Conduct or rules of the Pennsylvania Supreme Court governing the practice of law in Pennsylvania, unless such conflict, requirement or rule can be waived by the client and the client gives informed consent.

(h) For purposes of this Rule, the term "seller" means an individual lawyer or a law firm that sells a law practice or an area of law practice, and includes both the personal representative or estate of a deceased or disabled lawyer and the deceased or disabled lawyer, as appropriate.

(i) Admission to or withdrawal from a law partnership or professional association, retirement plan or similar arrangement or a sale limited to the tangible assets of a law practice is not a sale or purchase for purposes of this Rule 1.17.

Comment:

[1] The practice of law is a profession, not merely a business. Clients are not commodities that can be purchased and sold at will. Pursuant to this Rule, when a lawyer or a law firm ceases to engage in the private practice of law or ceases to practice in an area of law in Pennsylvania and other lawyers or firms take over the representation of the clients of the seller, the seller, including the personal representative or estate of a deceased or disabled lawyer, may obtain compensation for the reasonable value of the practice similar to

withdrawing partners of law firms. See Rules 5.4 and 5.6. Admission to or retirement from a law partnership or professional association, retirement plans and similar arrangements, and a sale of tangible assets of a law practice, do not constitute a sale or purchase governed by this Rule.

Termination of Practice by the Seller

The requirement that all of the private practice, or all of an area of practice, be sold is satisfied if the seller in good faith makes the entire practice, or the area of practice, available for sale to the purchasers. The fact that a number of the seller's clients decide not to be represented by the purchasers but take their matters elsewhere, therefore, does not result in a violation of this Rule. Return to private practice as a result of an unanticipated change in circumstances does not necessarily result in a violation. For example, a lawyer who has sold the practice to accept an appointment to a judicial office does not violate the requirement that the sale be attendant to cessation of practice if the lawyer later resumes private practice upon being defeated in a contested or a retention election for the office or resigns from a judiciary position.

[3] The requirement that the seller cease to engage in the private practice of law does not prohibit employment as a lawyer on the staff of a public agency or a legal services entity that provides legal services to the poor, or as in-house counsel to a business.

[4] This Rule also permits a lawyer or law firm to sell an area of practice. If an area of practice is sold and the lawyer remains in the active practice of law, the lawyer must cease accepting any matters in the area of practice that has been sold, either as counsel or co-counsel or by assuming joint responsibility for a matter in connection with the division of a fee with another lawyer as would otherwise be permitted by Rule 1.5(e). For example, a lawyer with a substantial number of estate planning matters and a substantial number of probate administration cases may sell the estate planning portion of the practice but remain in the practice of law by concentrating on probate administration; however, that practitioner may not thereafter accept any estate planning matters. Although a lawyer who leaves this jurisdiction typically would sell the entire practice, this Rule permits the lawyer to limit the sale to one or more areas of the practice, thereby preserving the lawyer's right to continue practice in the areas of the practice that were not sold.

Sale of Entire Practice or Entire Area of Practice

[5] This Rule requires that the seller's entire practice, or an entire area of practice, be sold. The prohibition against sale of less than an entire practice area protects those clients whose matters are less lucrative and who might find it difficult to secure other counsel if a sale could be limited to substantial fee generating matters. The purchasers are required to undertake all client matters in the practice, or practice area, subject to client consent. If, however, the purchaser is unable to undertake all client matters because of nonwaivable conflicts of interest, other requirements of these Rules or rules of the Supreme Court governing the practice of law in Pennsylvania, the requirement is nevertheless satisfied.

Client Confidences

[6] Negotiations between seller and prospective purchaser prior to disclosure of information relating to a specific representation of an identifiable client no more violate the confidentiality provisions of Rule 1.6 than do preliminary discussions concerning the possible association of another lawyer or mergers between firms with respect to which client consent is not required. See Rule 1.6(c)(6) and (7). Providing the purchaser access to the client-specific detailed information relating to the representation, such as the client's file, however, requires client consent. The Rule provides that before such information can be disclosed by the seller to the purchaser the client must be given written notice of the contemplated sale and file transfer including the identity of the purchaser and any proposed change in the terms of future representation, and must be told that the decision to consent or make other arrangements must be made within 60 days. If notice is given, and the client makes no response within the 60 day period, client consent to the sale will be presumed.

[5] The Rule provides the minimum notice to the seller's clients necessary to make the sale effective under the Rules of Professional Conduct. The person responsible for notice is encouraged to give sufficient information concerning the purchasing law firm or lawyer who will handle the matter so as to provide the client adequate information to make an informed decision concerning ongoing representation by the purchaser. Such information may include without limitation the buyer's background, education, experience with similar matters, length of practice, and whether the lawyer(s) are currently licensed in Pennsylvania.

[6] No single method is provided for the giving of actual written notice to the client under paragraph (c). It is up to the person undertaking to give notice to determine the most effective and efficient means for doing so. For many clients, certified mail with return receipt requested will be adequate. However, with regard to other clients, this method may not be the best method. It is up to the person responsible for giving notice to make this decision.

Notice and Consent

[7] Once an agreement is reached between the seller and the purchaser, the client must be given written notice of the contemplated sale and file transfer including the identity of the purchaser, and must be told that the decision to consent or make other arrangements must be made within 60 days. If notice is given, and the client makes no response within the 60 day period, client consent to the sale will be presumed. The Rule provides the minimum notice to the seller's clients necessary to make the sale effective under the Rules of Professional Conduct. The seller is encouraged to give sufficient information concerning the purchasing law firm or lawyer who will handle the matter so as to provide the client adequate information to make an informed decision concerning ongoing representation by the purchaser. Such information may include without limitation the purchaser's background, education, experience with similar matters, length of practice, and whether the purchaser is currently licensed in Pennsylvania.

[8] No single method is provided for the giving of written notice to the client under paragraph (c). It is up to the seller to determine the most effective and efficient means for doing so. For many clients, certified mail with return receipt requested will be adequate. However, with regard to other clients, this method may not be the best method. It is up to the seller to make this decision.

[9] All of the elements of client autonomy, including the client's absolute right to discharge a lawyer and transfer the representation to another, survive the sale of the practice or area of practice.

Fee Arrangements Between Client and Purchaser

[10] The sale may not be financed by increases in fees charged to the clients of the practice. This protection is underscored by both paragraph (c)(2) and paragraph (d). Existing agreements between the seller and the client as to the fees and the scope of the work must be honored by the purchaser, unless the client gives informed consent confirmed in writing.

Other Applicable Ethical Standards

[11] Lawyers participating in the sale of a law practice or a practice area are subject to ethical standards applicable to involving another lawyer in the representation of a client. These include, for example, the seller's obligation to exercise competence in identifying a purchaser qualified to assume the practice and the purchaser's obligation to undertake the representation competently (see Rule 1.1); the obligation to avoid disqualifying conflicts, and to secure the client's informed consent for those conflicts which can be waived by the client (see Rule 1.7 regarding conflicts and Rule 1.0(e) for the definition of informed consent); and the obligation to protect information relating to the representation. See Rules 1.6 and 1.9.

[12] If approval of the substitution of the purchasing attorney for the selling attorney is required by the Rules of any tribunal in which a matter is pending, such approval must be obtained before the matter can be included in the sale. See Rule 1.16.

Applicability of the Rule

[13] This Rule applies to the sale of a law practice by representatives of a deceased or disabled lawyer. Thus, the seller may be represented by a non-lawyer representative not subject to these Rules. Since, however, no lawyer may participate in the sale of a law practice which does not conform to the requirements of this Rule, the representatives of the seller as well as the purchaser can be expected to see to it that they are met.

[14] This Rule does not apply to transfers of legal representation between lawyers when such transfers are unrelated to the sale of a practice or an area of practice.

Rule 1.18 Duties to Prospective Clients

(a) A person who consults with a lawyer about the possibility of forming a client-lawyer relationship with respect to a matter is a prospective client.

(b) Even when no client-lawyer relationship ensues, a lawyer who has learned information from a prospective client shall not use or reveal information which may be significantly harmful to that person, except as Rule 1.9 would permit with respect to information of a former client.

(c) A lawyer subject to paragraph (b) shall not represent a client with interests materially adverse to those of a prospective client in the same or a substantially related matter if the lawyer learned information from the prospective client that could be significantly harmful to that person in the matter, except as provided in paragraph (d). If a lawyer is disqualified from representation under this paragraph, no lawyer in a firm with which that lawyer is associated may knowingly undertake or continue representation in such a matter, except as provided in paragraph (d).

(d) When a lawyer has learned information as defined in paragraph (c), representation is permissible if:

(1) both the affected client and the prospective client have given informed consent; or,

(2) all of the following apply:

(i) the disqualified lawyer took reasonable measures to avoid exposure to more disqualifying information than was reasonably necessary to determine whether to represent the prospective client;

(ii) the disqualified lawyer is screened from any participation in the matter and is apportioned no part of the fee therefrom; and

(iii) written notice is promptly given to the prospective client.

Comment:

[1] Prospective clients, like clients, may disclose information to a lawyer, place documents or other property in the lawyer's custody, or rely on the lawyer's advice. A lawyer's consultations with a prospective client usually are limited in time and depth and leave both the prospective client and the lawyer free (and sometimes required) to proceed no further. Hence, prospective clients should receive some but not all of the protection afforded clients.

[2] A person becomes a prospective client by consulting with a lawyer about the possibility of forming a client-lawyer relationship with respect to a matter. Whether communications, including written, oral, or electronic communications, constitute a consultation depends on the circumstances. For example, a consultation is likely to have occurred if a lawyer, either in person or through the lawyer's advertising in any medium, specifically requests or invites the submission of information about a potential representation without clear and reasonably understandable warnings and cautionary statements that limit the lawyer's obligations, and a person provides information in response. See also Comment [4]. In contrast, a consultation does not occur if a person provides information to a lawyer, such as in an unsolicited e-mail or other communication, in response to advertising that merely describes the lawyer's education, experience, areas of practice, and contact information, or provides legal information of general interest. Such a person communicates information unilaterally to a lawyer without any reasonable expectation that a client-lawyer relationship will be established, and is thus not a "prospective client." A person who participates in an initial consultation**,** or communicates information, with the intent to disqualify a lawyer from representing a client with materially adverse interests is not entitled to the protections of paragraphs (b) or (c) of this Rule. A person's intent to disqualify may be inferred from the circumstances.

[3] It is often necessary for a prospective client to reveal information to the lawyer during an initial consultation prior to the decision about formation of a client-lawyer relationship. The lawyer often must learn such information to determine whether there is a conflict of interest with an existing client and whether the matter is one that the lawyer is willing to undertake. Paragraph (b) prohibits the lawyer from using or revealing

significantly harmful information, except as permitted by Rule 1.9, even if the client or lawyer decides not to proceed with the representation. The duty exists regardless of how brief the initial conference may be.

[4] In order to avoid acquiring disqualifying information from a prospective client, a lawyer considering whether or not to undertake a new matter should limit the initial consultation to only such information as reasonably appears necessary for that purpose. Where the information indicates that a conflict of interest or other reason for non-representation exists, the lawyer should so inform the prospective client or decline the representation. If the prospective client wishes to retain the lawyer, and if consent is possible under Rule 1.7, then consent from all affected present or former clients must be obtained before accepting the representation.

[5] A lawyer may condition a consultation with a prospective client on the person's informed consent that no information disclosed during the consultation will prohibit the lawyer from representing a different client in the matter. See Rule 1.0(e) for the definition of informed consent. If the agreement expressly so provides, the prospective client may also consent to the lawyer's subsequent use of information received from the prospective client.

[6] Even in the absence of an agreement, under paragraph (c) the lawyer is not prohibited from representing a client with interests adverse to those of the prospective client in the same or a substantially related matter unless the lawyer has received from the prospective client information that could be significantly harmful if used in the matter.

[7] Under paragraph (c), the prohibition in this Rule is imputed to other lawyers as provided in Rule 1.10, but, under paragraph (d)(1), imputation may be avoided if the lawyer obtains the informed consent of both the prospective and affected clients. In the alternative, imputation may be avoided if the conditions of paragraph (d)(2) are met and all disqualified lawyers are timely screened and written notice is promptly given to the prospective client. See Rule 1.0(k) (requirements for screening procedures). Paragraph (d)(2)(ii) does not prohibit the screened lawyer from receiving a salary or partnership share established by prior independent agreement, but that lawyer may not receive compensation directly related to the matter in which the lawyer is disqualified.

[8] Notice, including a description of the screened lawyer's prior representation and of the screening procedures employed, generally should be given as soon as practicable after the need for screening becomes apparent.

[9] For the duty of competence of a lawyer who gives assistance on the merits of a matter to a prospective client, see Rule 1.1. For a lawyer's duties when a prospective client entrusts valuables or papers to the lawyer's care, see Rule 1.15.

Rule 1.19 Lawyers Acting as Lobbyists

(a) A lawyer acting as lobbyist, as defined in any statute, resolution passed or adopted by either house of the Legislature, regulation promulgated by the Executive Branch or any agency of the Commonwealth of Pennsylvania, or ordinance enacted by a local government unit, shall comply with all regulation, disclosure, or other requirements of such statute, resolution, regulation or ordinance which are consistent with the Rules of Professional Conduct.

(b) Any disclosure of information relating to representation of a client made by the lawyer-lobbyist in order to comply with such statute, resolution, regulation or ordinance is a disclosure explicitly authorized to carry out the representation and does not violate Rule 1.6.

(c) A lawyer whose service as a public officer or public employee of a governmental body concludes on or after June 1, 2023, shall not act as a lobbyist, as defined in any statute, resolution passed or adopted by either house of the Legislature, regulation promulgated by the Executive Branch or any agency of the Commonwealth of Pennsylvania or ordinance enacted by a local government unit, on any other matter before the governmental body with which the lawyer had been associated for one year after termination of the lawyer’s service as a public officer or public employee.

Comment:

[1] A "local government unit" includes county and municipal or local authorities in the Commonwealth.

COUNSELOR

Rule 2.1 Advisor

In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation.

Comment:

Scope of Advice

[1] A client is entitled to straightforward advice expressing the lawyer's honest assessment. Legal advice often involves unpleasant facts and alternatives that a client may be disinclined to confront. In presenting advice, a lawyer endeavors to sustain the client's morale and may put advice in as acceptable a form as honesty permits. However, a lawyer should not be deterred from giving candid advice by the prospect that the advice will be unpalatable to the client.

[2] Advice couched in narrow legal terms may be of little value to a client, especially where practical considerations, such as cost or effects on other people, are predominant. Purely technical legal advice, therefore, can sometimes be inadequate. It is proper for a lawyer to refer to relevant moral and ethical considerations in giving advice. Although a lawyer is not a moral advisor as such, moral and ethical considerations impinge upon most legal questions and may decisively influence how the law will be applied.

[3] A client may expressly or impliedly ask the lawyer for purely technical advice. When such a request is made by a client experienced in legal matters, the lawyer may accept it at face value. When such a request is made by a client inexperienced in legal matters, however, the lawyer's responsibility as advisor may include indicating that more may be involved than strictly legal considerations.

[4] Matters that go beyond strictly legal questions may also be in the domain of another profession. Family matters can involve problems within the professional competence of psychiatry, clinical psychology or social work; business matters can involve problems within the competence of the accounting profession or of financial specialists. Where consultation with a professional in another field is itself something a competent lawyer would recommend, the lawyer should make such a recommendation. At the same time, a lawyer's advice at its best often consists of recommending a course of action in the face of conflicting recommendations of experts.

Offering Advice

[5] In general, a lawyer is not expected to give advice until asked by the client. However, when a lawyer knows that a client proposes a course of action that is likely to result in substantial adverse legal consequences to the client, the lawyer's duty to the client under Rule 1.4 may require that the lawyer offer advice if the client's course of action is related to the representation. Similarly, when a matter is likely to involve litigation, it may be necessary under Rule 1.4 to inform the client of forms of dispute resolution that might constitute reasonable alternatives to litigation. A lawyer ordinarily has no duty to initiate investigation of a client's affairs or to give advice that the client has indicated is unwanted, but a lawyer may initiate advice to a client when doing so appears to be in the client's interest.

Rule 2.2 [Reserved]

Rule 2.3 Evaluation for Use by Third Persons

(a) A lawyer may provide an evaluation of a matter affecting a client for the use of someone other than the client if the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer's relationship with the client.

(b) When the lawyer knows or reasonably should know that the evaluation is likely to affect the client's interests materially and adversely, the lawyer shall not provide the evaluation unless the client gives informed consent.

(c) Except as disclosure is authorized in connection with a report of an evaluation, information relating to the evaluation is otherwise protected by Rule 1.6.

Comment:

Definition

[1] An evaluation may be performed at the client's direction or when impliedly authorized in order to carry out the representation. See Rule 1.2. Such an evaluation may be for the primary purpose of establishing information for the benefit of third parties, for example, an opinion concerning the title of property rendered at the behest of a vendor for the information of a prospective purchaser, or at the behest of a borrower for the information of a prospective lender. In some situations, the evaluation may be required by a government agency, for example, an opinion concerning the legality of the securities registered for sale under the securities laws. In other instances, the evaluation may be required by a third person, such as a purchaser of a business.

[2] A legal evaluation should be distinguished from an investigation of a person with whom the lawyer does not have a client-lawyer relationship. For example, a lawyer retained by a purchaser to analyze a vendor's title to property does not have a client-lawyer relationship with the vendor. So also, an investigation into a person's affairs by a government lawyer, or by special counsel employed by the government, is not an evaluation as that term is used in this Rule. The question is whether the lawyer is retained by the person whose affairs are being examined. When the lawyer is retained by that person, the general rules concerning loyalty to client and preservation of confidences apply, which is not the case if the lawyer is retained by someone else. For this reason, it is essential to identify the person by whom the lawyer is retained. This should be made clear not only to the person under examination, but also to others to whom the results are to be made available.

Duties Owed to Third Person and Client

[3] When the evaluation is intended for the information or use of a third person, a legal duty to that person may or may not arise. That legal question is beyond the scope of this Rule. However, since such an evaluation involves a departure from the normal client-lawyer relationship, careful analysis of the situation is required. The lawyer must be satisfied as a matter of professional judgment that making the evaluation is compatible with other functions undertaken in behalf of the client. For example, if the lawyer is acting as advocate in defending the client against charges of fraud, it would normally be incompatible with that responsibility for the lawyer to perform an evaluation for others concerning the same or a related transaction. Assuming no such impediment is apparent, however, the lawyer should advise the client of the implications of the evaluation, particularly the lawyer's responsibilities to third persons and the duty to disseminate the findings.

Scope of Evaluation

[4] The quality of an evaluation depends on the freedom and extent of the investigation upon which it is based. Ordinarily a lawyer should have whatever latitude of investigation seems necessary as a matter of professional judgment. Under some circumstances, however, the terms of the evaluation may be limited. For example, certain issues or sources may be categorically excluded, or the scope of search may be limited by time constraints or the noncooperation of persons having relevant information. Any such limitations which are material to the evaluation should be described in the report. If after a lawyer has commenced an evaluation, the client refuses to comply with the terms upon which it was understood the evaluation was to have been made, the lawyer's obligations are determined by law, having reference to the terms of the client's agreement and the surrounding circumstances. In no circumstances is the lawyer permitted to knowingly make a false statement of material fact or law in providing an evaluation under this Rule. See Rule 4.1.

Confidential Information

[5] Information relating to an evaluation is protected by Rule 1.6. In many situations, providing an evaluation to a third party poses no significant risk to the client; thus, the lawyer may be impliedly

authorized to disclose information to carry out the representation. See Rule 1.6(a). Where, however, it is reasonably likely that providing the evaluation will affect the client's interests materially and adversely, the lawyer must first obtain the client's consent after the client has been adequately informed concerning the important possible effects on the client's interests. See Rule 1.6(a) and Rule 1.0(e) (Informed Consent).

Financial Auditors' Requests for Information

[6] When a question concerning the legal situation of a client arises at the instance of the client's financial auditor and the question is referred to the lawyer, the lawyer's response may be made in accordance with procedures recognized in the legal profession. Such a procedure is set forth in the American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information, adopted in 1975.

Rule 2.4 Lawyer Serving as Third-Party Neutral

(a) A lawyer serves as a third-party neutral when the lawyer assists two or more persons who are not clients of the lawyer to reach a resolution of a dispute or other matter that has arisen between them. Service as a third-party neutral may include service as an arbitrator, a mediator or in such other capacity as will enable the lawyer to assist the parties to resolve the matter.

(b) A lawyer serving as a third-party neutral shall inform unrepresented parties that the lawyer is not representing them. When the lawyer knows or reasonably should know that a party does not understand the lawyer's role in the matter, the lawyer shall explain the difference between the lawyer's role as a third-party neutral and a lawyer's role as one who represents a client.

Comment:

[1] Alternative dispute resolution has become a substantial part of the civil justice system. Aside from representing clients in dispute-resolution processes, lawyers often serve as third-party neutrals. A third-party neutral is a person, such as a mediator, arbitrator, conciliator or evaluator, who assists the parties, represented or unrepresented, in the resolution of a dispute or in the arrangement of a transaction. Whether a third-party neutral serves primarily as a facilitator, evaluator or decision maker depends on the particular process that is either selected by the parties or mandated by a court.

[2] The role of a third-party neutral is not unique to lawyers, although, in some court-connected contexts, only lawyers are allowed to serve in this role or to handle certain types of cases. In performing this role, the lawyer may be subject to court rules or other law that apply either to third-party neutrals generally or to lawyers serving as third-party neutrals. Lawyer-neutrals may also be subject to various codes of ethics, such as the Code of Ethics for Arbitration in Commercial Disputes prepared by a joint committee of the American Bar Association and the American Arbitration Association or the Model Standards of Conduct for Mediators jointly prepared by the American Bar Association, the American Arbitration Association and the Society of Professionals in Dispute Resolution.

[3] Unlike nonlawyers who serve as third-party neutrals, lawyers serving in this role may experience unique problems as a result of differences between the role of a third-party neutral and a lawyer's service as a client representative. The potential for confusion is significant when the parties are unrepresented in the process. Thus, paragraph (b) requires a lawyer-neutral to inform unrepresented parties that the lawyer is not representing them. For some parties, particularly parties who frequently use dispute-resolution processes, this information will be sufficient. For others, particularly those who are using the process for the first time, more information will be required. Where appropriate, the lawyer should inform unrepresented parties of the important differences between the lawyer's role as third-party neutral and a lawyer's role as a client representative, including the inapplicability of the attorney-client evidentiary privilege. The extent of disclosure required under this paragraph will depend on the particular parties involved and the subject matter of the proceeding, as well as the particular features of the dispute-resolution process selected.

[4] A lawyer who serves as a third-party neutral subsequently may be asked to serve as a lawyer representing a client in the same matter. The conflicts of interest that arise for both the individual lawyer and the lawyer's law firm are addressed in Rule 1.12.

[5] Lawyers who represent clients in alternative dispute-resolution processes are governed by the Rules of Professional Conduct. When the dispute-resolution process takes place before a tribunal, as in binding arbitration (see Rule 1.0(m)), the lawyer's duty of candor is governed by Rule 3.3. Otherwise, the lawyer's duty of candor toward both the third-party neutral and other parties is governed by Rule 4.1.

ADVOCATE

Rule 3.1 Meritorious Claims and Contentions

A lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis in law and fact for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law. A lawyer for the defendant in a criminal proceeding, or the respondent in a proceeding that could result in incarceration, may nevertheless so defend the proceeding as to require that every element of the case be established.

Comment:

[1] The advocate has a duty to use legal procedure for the fullest benefit of the client's cause, but also a duty not to abuse legal procedure. The law, both procedural and substantive, establishes the limits within which an advocate may proceed. However, the law is not always clear and never is static. Accordingly, in determining the proper scope of advocacy, account must be taken of the law's ambiguities and potential for change.

[2] The filing of an action or defense or similar action taken for a client is not frivolous merely because the facts have not first been fully substantiated or because the lawyer expects to develop vital evidence only by discovery. What is required of lawyers, however, is that they inform themselves about the facts of their clients' cases and the applicable law and determine that they can make good faith arguments in support of their clients' positions. Such action is not frivolous even though the lawyer believes that the client's position ultimately will not prevail. The action is frivolous, however, if the lawyer is unable either to make a good faith argument on the merits of the action taken or to support the action taken by a good faith argument for an extension, modification or reversal of existing law.

[3] The lawyer's obligations under this Rule are subordinate to federal or state constitutional law that entitles a defendant in a criminal matter to the assistance of counsel in presenting a claim or contention that otherwise would be prohibited by this Rule.

Rule 3.2 Expediting Litigation

A lawyer shall make reasonable efforts to expedite litigation consistent with the interests of the client.

Comment:

[1] Dilatory practices bring the administration of justice into disrepute. Although there will be occasions when a lawyer may properly seek a postponement for personal reasons, it is not proper for a lawyer to routinely fail to expedite litigation solely for the convenience of the advocates. Nor will a failure to expedite be reasonable if done for the purpose of frustrating an opposing party's attempt to obtain rightful redress or repose. It is not a justification that similar conduct is often tolerated by the bench and bar. The question is whether a competent lawyer acting in good faith would regard the course of action as having some substantial purpose other than delay. Realizing financial or other benefit from otherwise improper delay in litigation is not a legitimate interest of the client.

Rule 3.3 Candor Toward the Tribunal

(a) A lawyer shall not knowingly:

(1) make a false statement of material fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;

(2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or

(3) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence before a tribunal or in an ancillary proceeding conducted pursuant to a tribunal's adjudicative authority, such as a deposition, and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.

(b) A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

(c) The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.

(d) In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.

Comment:

[1] This Rule governs the conduct of a lawyer who is representing a client in the proceedings of a tribunal. See Rule 1.0(m) for the definition of "tribunal." It also applies when the lawyer is representing a client in an ancillary proceeding conducted pursuant to the tribunal's adjudicative authority, such as a deposition. Thus, for example, paragraph (a)(3) requires a lawyer to take reasonable remedial measures if the lawyer comes to know that a client who is testifying in a deposition has offered evidence that is false.

[2] This Rule sets forth the special duties of lawyers as officers of the court to avoid conduct that undermines the integrity of the adjudicative process. A lawyer acting as an advocate in an adjudicative proceeding has an obligation to present the client's case with persuasive force. Performance of that duty while maintaining confidences of the client, however, is qualified by the advocate's duty of candor to the tribunal. Consequently, although a lawyer in an adversary proceeding is not required to present an impartial exposition of the law or to vouch for the evidence submitted in a cause, the lawyer must not allow the tribunal to be misled by false statements of law or fact or evidence that the lawyer knows to be false.

Representations by a Lawyer

[3] An advocate is responsible for pleadings and other documents prepared for litigation, but is usually not required to have personal knowledge of matters asserted therein, for litigation documents ordinarily present assertions by the client, or by someone on the client's behalf, and not assertions by the lawyer. Compare Rule 3.1. However, an assertion purporting to be on the lawyer's own knowledge, as in an affidavit by the lawyer or in a statement in open court, may properly be made only when the lawyer knows the assertion is true or believes it to be true on the basis of a reasonably diligent inquiry. There are circumstances where failure to make a disclosure is the equivalent of an affirmative misrepresentation. The obligation prescribed in Rule 1.2(d) not to counsel a client to commit or assist the client in committing a fraud applies in litigation. Regarding compliance with Rule 1.2(d), see the Comment to that Rule. See also the Comment to Rule 8.4(b).

Legal Argument

[4] Legal argument based on a knowingly false representation of law constitutes dishonesty toward the tribunal. A lawyer is not required to make a disinterested exposition of the law, but must recognize the existence of pertinent legal authorities. Furthermore, as stated in paragraph (a)(2), an advocate has a duty to disclose directly adverse authority in the controlling jurisdiction that has not been disclosed by the opposing party. The underlying concept is that legal argument is a discussion seeking to determine the legal premises properly applicable to the case.

Offering Evidence

[5] Paragraph (a)(3) requires that the lawyer refuse to offer evidence that the lawyer knows to be false, regardless of the client's wishes. This duty is premised on the lawyer's obligation as an officer of the court to prevent the trier of fact from being misled by false evidence. A lawyer does not violate this Rule if the lawyer offers the evidence for the purpose of establishing its falsity.

[6] If a lawyer knows that the client intends to testify falsely or wants the lawyer to introduce false evidence, the lawyer should seek to persuade the client that the evidence should not be offered. If the persuasion is ineffective and the lawyer continues to represent the client, the lawyer must refuse to offer the false evidence. If only a portion of a witness's testimony will be false, the lawyer may call the witness to testify but may not elicit or otherwise permit the witness to present the testimony that the lawyer knows is false.

[7] The duties stated in paragraphs (a) and (b) apply to all lawyers, including defense counsel in criminal cases. In some jurisdictions, however, courts have required counsel to present the accused as a witness or to give a narrative statement if the accused so desires, even if counsel knows that the testimony or statement will be false. The obligation of the advocate under the Rules of Professional Conduct is subordinate to such requirements. See also Comment [9].

[8] The prohibition against offering false evidence only applies if the lawyer knows that the evidence is false. A lawyer's reasonable belief that evidence is false does not preclude its presentation to the trier of fact. A lawyer's knowledge that evidence is false, however, can be inferred from the circumstances. See Rule 1.0(f). Thus, although a lawyer should resolve doubts about the veracity of testimony or other evidence in favor of the client, the lawyer cannot ignore an obvious falsehood.

[9] Although paragraph (a)(3) only prohibits a lawyer from offering evidence the lawyer knows to be false, it permits the lawyer to refuse to offer testimony or other proof that the lawyer reasonably believes is false. Offering such proof may reflect adversely on the lawyer's ability to discriminate in the quality of evidence and thus impair the lawyer's effectiveness as an advocate. Because of the special protections historically provided criminal defendants, however, this Rule does not permit a lawyer to refuse to offer the testimony of such a client where the lawyer reasonably believes but does not know that the testimony will be false. Unless the lawyer knows the testimony will be false, the lawyer must honor the client's decision to testify. See also Comment [7].

Remedial Measures

[10] Having offered material evidence in the belief that it was true, a lawyer may subsequently come to know that the evidence is false. Or, a lawyer may be surprised when the lawyer's client, or another witness called by the lawyer, offers testimony the lawyer knows to be false, either during the lawyer's direct examination or in response to cross-examination by the opposing lawyer. In such situations or if the lawyer knows of the falsity of testimony elicited from the client during a deposition, the lawyer must take reasonable remedial measures. In such situations, the advocate's proper course is to remonstrate with the client confidentially, advise the client of the lawyer's duty of candor to the tribunal and seek the client's cooperation with respect to the withdrawal or correction of the false statements or evidence. If that fails, the advocate must take further remedial action. If withdrawal from the representation is not permitted or will not undo the effect of the false evidence, the advocate must make such disclosure to the tribunal as is reasonably necessary to remedy the situation, even if doing so requires the lawyer to reveal information that otherwise would be protected by Rule 1.6. It is for the tribunal then to determine what should be done — making a statement about the matter to the trier of fact, ordering a mistrial or perhaps nothing.

[11] The disclosure of a client's false testimony can result in grave consequences to the client, including not only a sense of betrayal but also loss of the case and perhaps a prosecution for perjury. But the alternative is that the lawyer cooperate in deceiving the court, thereby subverting the truth-finding process which the adversary system is designed to implement. See Rule 1.2(d). Furthermore, unless it is clearly understood that the lawyer will act upon the duty to disclose the existence of false evidence, the client can simply reject the lawyer's advice to reveal the false evidence and insist that the lawyer keep silent. Thus the client could in effect coerce the lawyer into being a party to fraud on the court.

Preserving Integrity of Adjudicative Process

[12] Lawyers have a special obligation to protect a tribunal against criminal or fraudulent conduct that undermines the integrity of the adjudicative process, such as bribing, intimidating or otherwise unlawfully communicating with a witness, juror, court official or other participant in the proceeding, unlawfully destroying or concealing documents or other evidence or failing to disclose information to the tribunal when required by law to do so. Thus, paragraph (b) requires a lawyer to take reasonable remedial measures, including disclosure if necessary, whenever the lawyer knows that a person, including the lawyer's client, intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding.

Duration of Obligation

[13] A practical time limit on the obligation to rectify false evidence or false statements of law and fact has to be established. The conclusion of the proceeding is a reasonably definite point for the termination of the obligation. A proceeding has concluded within the meaning of this Rule when a final judgment in the proceeding has been affirmed on appeal or the time for review has passed.

Ex Parte Proceedings

[14] Ordinarily, an advocate has the limited responsibility of presenting one side of the matters that a tribunal should consider in reaching a decision; the conflicting position is expected to be presented by the opposing party. However, in any ex parte proceeding, such as an application for a temporary restraining order, there is no balance of presentation by opposing advocates. The object of an ex parte proceeding is nevertheless to yield a substantially just result. The judge has an affirmative responsibility to accord the absent party just consideration. The lawyer for the represented party has the correlative duty to make disclosures of material facts known to the lawyer and that the lawyer reasonably believes are necessary to an informed decision.

Withdrawal

[15] Normally, a lawyer's compliance with the duty of candor imposed by this Rule does not require that the lawyer withdraw from the representation of a client whose interests will be or have been adversely affected by the lawyer's disclosure. The lawyer may, however, be required by Rule 1.16 to seek permission of the tribunal to withdraw if the lawyer's compliance with this Rule's duty of candor results in such an extreme deterioration of the client-lawyer relationship that the lawyer can no longer competently represent the client. Also see Rule 1.16(b) for the circumstances in which a lawyer will be permitted to seek a tribunal's permission to withdraw. In connection with a request for permission to withdraw that is premised on a client's misconduct, a lawyer may reveal information relating to the representation only to the extent reasonably necessary to comply with this Rule or as otherwise permitted by Rule 1.6.

Rule 3.4 Fairness to Opposing Party and Counsel

A lawyer shall not:

(a) unlawfully obstruct another party's access to evidence or unlawfully alter, destroy or conceal a document or other material having potential evidentiary value or assist another person to do any such act;

(b) falsify evidence, counsel or assist a witness to testify falsely, pay, offer to pay, or acquiesce in the payment of compensation to a witness contingent upon the content of the witness' testimony or the outcome of the case; but a lawyer may pay, cause to be paid, guarantee or acquiesce in the payment of:

(1) expenses reasonably incurred by a witness in attending or testifying;

(2) reasonable compensation to a witness for the witness' loss of time in attending or testifying; and,

(3) a reasonable fee for the professional services of an expert witness;

(c) when appearing before a tribunal, assert the lawyer's personal opinion as to the justness of a cause, as to the credibility of a witness, as to the culpability of a civil litigant, or as to the guilt or innocence

of an accused; but the lawyer may argue, on the lawyer's analysis of the evidence, for any position or conclusion with respect to the matters stated herein; or,

(d) request a person other than a client to refrain from voluntarily giving relevant information to another party unless:

(1) the person is a relative or an employee or other agent of a client; and,

(2) the lawyer reasonably believes that the person's interests will not be adversely affected by refraining from giving such information and such conduct is not prohibited by Rule 4.2.

Comment:

[1] The procedure of the adversary system contemplates that the evidence in a case is to be marshalled competitively by the contending parties. Fair competition in the adversary system is secured by prohibitions against destruction or concealment of evidence, improperly influencing witnesses, obstructive tactics in discovery procedure, and the like.

[2] Documents and other items of evidence are often essential to establish a claim or defense. Subject to evidentiary privileges, the right of an opposing party, including the government, to obtain evidence through discovery or subpoena is an important procedural right. The exercise of that right can be frustrated if relevant material is altered, concealed or destroyed. Applicable law in many jurisdictions makes it an offense to destroy material for purpose of impairing its availability in a pending proceeding or one whose commencement can be foreseen. Falsifying evidence is also generally a criminal offense. Paragraph (a) applies to evidentiary material generally, including computerized information. Applicable law may permit a lawyer to take temporary possession of physical evidence of client crimes for the purpose of conducting a limited examination that will not alter or destroy material characteristics of the evidence. In such a case, applicable law may require the lawyer to turn the evidence over to the police or other prosecuting authority, depending on the circumstances.

[3] With regard to paragraph (b), it is not improper to pay a witness's expenses or to compensate an expert witness on terms permitted by law. The common law rule in most jurisdictions is that it is improper to pay an occurrence witness any fee for testifying and that it is improper to pay an expert witness a contingent fee.

[4] Paragraph (d) permits a lawyer to advise employees of a client to refrain from giving information to another party, for the employees may identify their interests with those of the client. See also Rules 4.2 and 4.3(b).

Rule 3.5 Impartiality and Decorum of the Tribunal

A lawyer shall not:

(a) seek to influence a judge, juror, prospective juror or other official by means prohibited by law;

(b) communicate ex parte with such a person during the proceeding unless authorized to do so by law or court order;

(c) communicate with a juror or prospective juror after discharge of the jury if:

(1) the communication is prohibited by law or court order;

(2) the juror has made known to the lawyer a desire not to communicate; or,

(3) the communication involves misrepresentation, coercion, duress or harassment; or

(d) engage in conduct intended to disrupt a tribunal.

Comment:

[1] Many forms of improper influence upon a tribunal are proscribed by criminal law. Others are specified in the Code of Judicial Conduct and/or the Rules Governing Standards of Conduct for Magisterial District Judges, with which an advocate should be familiar. A lawyer is required to avoid contributing to a violation of such provisions.

[2] During a proceeding a lawyer may not communicate ex parte with persons serving in an official capacity in the proceeding, such as judges, masters or jurors, unless authorized to do so by law or court order.

[3] A lawyer may on occasion want to communicate with a juror or prospective juror after the jury has been discharged. The lawyer may do so unless the communication is prohibited by law or a court order but must respect the desire of the juror not to talk with the lawyer. The lawyer may not engage in improper conduct during the communication.

[4] The advocate's function is to present evidence and argument so that the cause may be decided according to law. Refraining from abusive or obstreperous conduct is a corollary of the advocate's right to speak on behalf of litigants. A lawyer may stand firm against abuse by a judge but should avoid reciprocation; the judge's default is no justification for similar dereliction by an advocate. An advocate can present the cause, protect the record for subsequent review and preserve professional integrity by patient firmness no less effectively than by belligerence or theatrics.

[5] The duty to refrain from disruptive conduct applies to any proceeding of a tribunal, including a deposition. See Rule 1.0(m).

Rule 3.6 Trial Publicity

(a) A lawyer who is participating or has participated in the investigation or litigation of a matter shall not make an extrajudicial statement that the lawyer knows or reasonably should know will be disseminated by means of public communication and will have a substantial likelihood of materially prejudicing an adjudicative proceeding in the matter.

(b) Notwithstanding paragraph (a), a lawyer may state:

(1) the claim, offense or defense involved and, except when prohibited by law, the identity of the persons involved;

(2) information contained in a public record;

(3) that an investigation of the matter is in progress;

(4) the scheduling or result of any step in litigation;

(5) a request for assistance in obtaining evidence and information necessary thereto;

(6) a warning of danger concerning the behavior of a person involved, when there is reason to believe that there exists the likelihood of substantial harm to an individual or to the public interest; and

(7) in a criminal case, in addition to subparagraphs (1) through (6):

(i) the identity, residence, occupation and family status of the accused;

(ii) if the accused has not been apprehended, information necessary to aid in apprehension of that person;

(iii) the fact, time and place of arrest; and,

(iv) the identity of investigating and arresting officers or agencies and the length of the investigation.

(c) Notwithstanding paragraph (a), a lawyer may make a statement that a reasonable lawyer would believe is required to protect a client from the substantial undue prejudicial effect of recent publicity not initiated by the lawyer or the lawyer's client. A statement made pursuant to this paragraph shall be limited to such information as is necessary to mitigate the recent adverse publicity.

(d) No lawyer associated in a firm or government agency with a lawyer subject to paragraph (a) shall make a statement prohibited by paragraph (a).

Comment:

[1] It is difficult to strike a balance between protecting the right to a fair trial and safeguarding the right of free expression. Preserving the right to a fair trial necessarily entails some curtailment of the information that may be disseminated about a party prior to trial, particularly where trial by jury is involved. If there were no such limits, the result would be the practical nullification of the protective effect of the rules of forensic decorum and the exclusionary rules of evidence. On the other hand, there are vital social interests served by the free dissemination of information about events having legal consequences and about legal proceedings themselves. The public has a right to know about threats to its safety and measures aimed at assuring its security. It also has a legitimate interest in the conduct of judicial proceedings, particularly in matters of general public concern. Furthermore, the subject matter of legal proceedings is often of direct significance in debate and deliberation over questions of public policy.

[2] Special rules of confidentiality may validly govern proceedings in juvenile, domestic relations and mental disability proceedings, and perhaps other types of litigation. Rule 3.4(c) requires compliance with such rules.

[3] The Rule sets forth a basic general prohibition against a lawyer's making statements that the lawyer knows or should know will have a substantial likelihood of materially prejudicing an adjudicative proceeding. Recognizing that the public value of informed commentary is great and the likelihood of prejudice to a proceeding by the commentary of a lawyer who is not involved in the proceeding is small, the Rule applies only to lawyers who are, or who have been involved in the investigation or litigation of a case, and their associates.

[4] Paragraph (b) identifies specific matters about which a lawyer's statements would not ordinarily be considered to present a substantial likelihood of material prejudice, and should not in any event be considered prohibited by the general prohibition of paragraph (a). Paragraph (b) is not intended to be an exhaustive listing of the subjects upon which a lawyer may make a statement, but statements on other matters may be subject to paragraph (a).

[5] There are, on the other hand, certain subjects that are more likely than not to have a material prejudicial effect on a proceeding, particularly when they refer to a civil matter triable to a jury, a criminal matter, or any other proceeding that could result in incarceration. These subjects relate to:

(1) the character, credibility, reputation or criminal record of a party, suspect in a criminal investigation or witness, or the identity of a witness, or the expected testimony of a party or witness;

(2) in a criminal case or proceeding that could result in incarceration, the possibility of a plea of guilty to the offense or the existence or contents of any confession, admission, or statement given by a defendant or suspect or that person's refusal or failure to make a statement;

(3) the performance or results of any examination or test or the refusal or failure of a person to submit to an examination or test, or the identity or nature of physical evidence expected to be presented;

(4) any opinion as to the guilt or innocence of a defendant or suspect in a criminal case or proceeding that could result in incarceration;

(5) information that the lawyer knows or reasonably should know is likely to be inadmissible as evidence in a trial and that would, if disclosed, create a substantial risk of prejudicing an impartial trial; or,

(6) the fact that a defendant has been charged with a crime, unless there is included therein a statement explaining that the charge is merely an accusation and that the defendant is presumed innocent until and unless proven guilty.

[6] Another relevant factor in determining prejudice is the nature of the proceeding involved. Criminal jury trials will be most sensitive to extrajudicial speech. Civil trials may be less sensitive. Non-jury hearings and arbitration proceedings may be even less affected. The Rule will still place limitations on prejudicial comments in these cases, but the likelihood of prejudice may be different depending on the type of proceeding.

[7] Finally, extrajudicial statements that might otherwise raise a question under this Rule may be permissible when they are made in response to statements made publicly by another party, another party's lawyer, or third persons, where a reasonable lawyer would believe a public response is required in order to avoid prejudice to the lawyer's client. When prejudicial statements have been publicly made by others, responsive statements may have the salutary effect of lessening any resulting adverse impact on the adjudicative proceeding. Such responsive statements should be limited to contain only such information as is necessary to mitigate undue prejudice created by the statements made by others.

[8] See Rule 3.8(e) for additional duties of prosecutors in connection with extrajudicial statements about criminal proceedings.

Rule 3.7 Lawyer as Witness

(a) A lawyer shall not act as advocate at a trial in which the lawyer is likely to be a necessary witness unless:

(1) the testimony relates to an uncontested issue;

(2) the testimony relates to the nature and value of legal services rendered in the case; or,

(3) disqualification of the lawyer would work substantial hardship on the client.

(b) A lawyer may act as advocate in a trial in which another lawyer in the lawyer's firm is likely to be called as a witness unless precluded from doing so by Rule 1.7 or Rule 1.9.

Comment:

[1] Combining the roles of advocate and witness can prejudice the tribunal and the opposing party and can also involve a conflict of interest between the lawyer and client.

Advocate-Witness Rule

[2] The tribunal has proper objection when the trier of fact may be confused or misled by a lawyer serving as both advocate and witness. The opposing party has proper objection where the combination of roles may prejudice that party's rights in the litigation. A witness is required to testify on the basis of personal knowledge, while an advocate is expected to explain and comment on evidence given by others. It may not be clear whether a statement by an advocate-witness should be taken as proof or as an analysis of the proof.

[3] To protect the tribunal, paragraph (a) prohibits a lawyer from simultaneously serving as advocate and necessary witness except in those circumstances specified in paragraphs (a)(1) through (a)(3). Paragraph (a)(1) recognizes that if the testimony will be uncontested, the ambiguities in the dual role are purely theoretical. Paragraph (a)(2) recognizes that where the testimony concerns the extent and value of legal services rendered in the action in which the testimony is offered, permitting the lawyers to testify avoids the need for a second trial with new counsel to resolve that issue. Moreover, in such a situation the judge has firsthand knowledge of the matter in issue; hence, there is less dependence on the adversary process to test the credibility of the testimony.

[4] Apart from these two exceptions, paragraph (a)(3) recognizes that a balancing is required between the interests of the client and those of the tribunal and the opposing party. Whether the tribunal is

likely to be misled or the opposing party is likely to suffer prejudice depends on the nature of the case, the importance and probable tenor of the lawyer's testimony, and the probability that the lawyer's testimony will conflict with that of other witnesses. Even if there is risk of such prejudice, in determining whether the lawyer should be disqualified, due regard must be given to the effect of disqualification on the lawyer's client. It is relevant that one or both parties could reasonably foresee that the lawyer would probably be a witness. The conflict of interest principles stated in Rules 1.7, 1.9, and 1.10 have no application to this aspect of the problem.

[5] Because the tribunal is not likely to be misled when a lawyer acts as advocate in a trial in which another lawyer in the lawyer's firm will testify as a necessary witness, paragraph (b) permits the lawyer to do so except in situations involving a conflict of interest.

Conflict of Interest

[6] In determining if it is permissible to act as advocate in a trial in which the lawyer will be a necessary witness, the lawyer must also consider that the dual role may give rise to a conflict of interest that will require compliance with Rules 1.7 or 1.9. For example, if there is likely to be substantial conflict between the testimony of the client and that of the lawyer, the representation involves a conflict of interest that requires compliance with Rule 1.7. This would be true even though the lawyer might not be prohibited by paragraph (a) from simultaneously serving as advocate and witness because the lawyer's disqualification would work a substantial hardship on the client. Similarly, a lawyer who might be permitted to simultaneously serve as an advocate and a witness by paragraph (a)(3) might be precluded from doing so by Rule 1.9. The problem can arise whether the lawyer is called as a witness on behalf of the client or is called by the opposing party. Determining whether or not such a conflict exists is primarily the responsibility of the lawyer involved. If there is a conflict of interest, the lawyer must secure the client's informed consent. In some cases, the lawyer will be precluded from seeking the client's consent. See Rule 1.7. See Rule 1.0(b) for the definition of "confirmed in writing" and Rule 1.0(e) for the definition of "informed consent."

[7] Paragraph (b) provides that a lawyer is not disqualified from serving as an advocate because a lawyer with whom the lawyer is associated in a firm is precluded from doing so by paragraph (a). If, however, the testifying lawyer would also be disqualified by Rule 1.7 or Rule 1.9 from representing the client in the matter, other lawyers in the firm will be precluded from representing the client by Rule 1.10 unless the client gives informed consent under the conditions stated in Rule 1.7.

Rule 3.8 Special Responsibilities of a Prosecutor

The prosecutor in a criminal case shall:

(a) refrain from prosecuting a charge that the prosecutor knows is not supported by probable cause;

(b) make reasonable efforts to assure that the accused has been advised of the right to, and the procedure for, obtaining counsel and has been given reasonable opportunity to obtain counsel;

(c) not seek to obtain from an unrepresented accused a waiver of important pretrial rights, such as the right to a preliminary hearing;

(d) make timely disclosure to the defense of all evidence or information known to the prosecutor that tends to negate the guilt of the accused or mitigates the offense, and, in connection with sentencing, disclose to the defense and to the tribunal all unprivileged mitigating information known to the prosecutor, except when the prosecutor is relieved of this responsibility by a protective order of the tribunal; and,

(e) except for statements that are necessary to inform the public of the nature and extent of the prosecutor's action and that serve a legitimate law enforcement purpose, refrain from making extrajudicial comments that have a substantial likelihood of heightening public condemnation of the accused and exercise reasonable care to prevent investigators, law enforcement personnel, employees or other persons assisting or associated with the prosecutor in a criminal case from making an extrajudicial statement that the prosecutor would be prohibited from making under Rule 3.6 or this Rule.

Comment:

[1] A prosecutor has the responsibility of a minister of justice and not simply that of an advocate. This responsibility carries with it specific obligations to see that the defendant is accorded procedural justice and that guilt is decided upon the basis of sufficient evidence. Precisely how far the prosecutor is required to go in this direction is a matter of debate and varies in different jurisdictions. Many jurisdictions have adopted the ABA Standards of Criminal Justice Relating to Prosecution Function, which in turn are the product of prolonged and careful deliberation by lawyers experienced in both criminal prosecution and defense. Applicable law may require other measures by the prosecutor and knowing disregard of those obligations or a systematic abuse of prosecutorial discretion could constitute a violation of Rule 8.4.

[2] In some jurisdictions, a defendant may waive a preliminary hearing and thereby lose a valuable opportunity to challenge probable cause. Accordingly, prosecutors should not seek to obtain waivers of preliminary hearings or other important pretrial rights from unrepresented accused persons. Paragraph (c) does not apply, however, to an accused appearing pro se with the approval of the tribunal. Nor does it forbid the lawful questioning of an uncharged suspect who has knowingly waived the rights to counsel and silence.

[3] The exception in paragraph (d) recognizes that a prosecutor may seek an appropriate protective order from the tribunal if disclosure of information to the defense could result in substantial harm to an individual or to the public interest.

[4] Paragraph (e) supplements Rule 3.6, which prohibits extrajudicial statements that have a substantial likelihood of prejudicing an adjudicatory proceeding. In the context of a criminal prosecution, a prosecutor's extrajudicial statement can create the additional problem of increasing public condemnation of the accused. Although the announcement of an indictment, for example, will necessarily have severe consequences for the accused, a prosecutor can, and should, avoid comments which have no legitimate law enforcement purpose and have a substantial likelihood of increasing public opprobrium of the accused. Nothing in this Comment is intended to restrict the statements which a prosecutor may make which comply with Rule 3.6(b) or 3.6(c).

Rule 3.9 Advocate in Nonadjudicative Proceedings

A lawyer representing a client before a legislative body or administrative agency in a nonadjudicative proceeding shall disclose that the appearance is in a representative capacity and shall conform to the provisions of Rules 3.3(a) through (c), 3.4(a) through (c), and 3.5.

Comment:

[1] In representation before bodies such as legislatures, municipal councils, and executive and administrative agencies acting in a rule-making or policy-making capacity, lawyers present facts, formulate issues and advance argument in the matters under consideration. The decision-making body, like a court, should be able to rely on the integrity of the submissions made to it. A lawyer appearing before such a body must deal with it honestly and in conformity with applicable rules of procedure. See Rules 3.3(a) through (c), 3.4 and 3.5.

[2] Lawyers have no exclusive right to appear before nonadjudicative bodies, as they do before a court. The requirements of this Rule therefore may subject lawyers to regulations inapplicable to advocates who are not lawyers. However, legislatures and administrative agencies have a right to expect lawyers to deal with them as they deal with courts.

[3] This Rule only applies when a lawyer represents a client in connection with an official hearing or meeting of a governmental agency or a legislative body to which the lawyer or the lawyer’s client is presenting evidence or argument. It does not apply to representation of a client in a negotiation or other bilateral transaction with a governmental agency or in connection with an application for a license or other privilege or the client’s compliance with generally applicable reporting requirements, such as the filing of income-tax returns. Nor does it apply to the representation of a client in connection with an investigation or examination of the client’s affairs conducted by government investigators or examiners. Representation in such matters is governed by Rules 4.1 through 4.4.

Rule 3.10 Issuance of Subpoenas to Lawyers

A public prosecutor or other governmental lawyer shall not, without prior judicial approval, subpoena an attorney to appear before a grand jury or other tribunal investigating criminal activity in circumstances where the prosecutor or other governmental lawyer seeks to compel the attorney/witness to provide evidence concerning a person who is or has been represented by the attorney/witness.

Comment:

[1] It is intended that the required "prior judicial approval" will normally be withheld unless, after a hearing conducted with due regard for the need for appropriate secrecy, the court finds (1) the information sought is not protected from disclosure by Rule 1.6, the attorney-client privilege or the work product doctrine; (2) the evidence sought is relevant to the proceeding; (3) compliance with the subpoena would not be unreasonable or oppressive; (4) the purpose of the subpoena is not primarily to harass the attorney/witness or his or her client; and (5) there is no other feasible alternative to obtain the information sought.

TRANSACTIONS WITH PERSONS OTHER THAN CLIENTS

Rule 4.1 Truthfulness in Statements to Others

In the course of representing a client a lawyer shall not knowingly:

(a) make a false statement of material fact or law to a third person; or,

(b) fail to disclose a material fact to a third person when disclosure is necessary to avoid aiding and abetting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

Comment:

Misrepresentation

[1] A lawyer is required to be truthful when dealing with others on a client's behalf, but generally has no affirmative duty to inform an opposing party of relevant facts. A misrepresentation can occur if the lawyer incorporates or affirms a statement of another person that the lawyer knows is false. Misrepresentations can also occur by partially true but misleading statements or omissions that are the equivalent of affirmative false statements. For dishonest conduct that does not amount to a false statement or for misrepresentations by a lawyer other than in the course of representing a client, see Rule 8.4.

Statements of Fact

[2] This Rule refers to statements of fact. Whether a particular statement should be regarded as one of fact can depend on the circumstances. Under generally accepted conventions in negotiation, certain types of statements ordinarily are not taken as statements of material fact. Estimates of price or value placed on the subject of a transaction and a party's intentions as to an acceptable settlement of a claim are ordinarily in this category, and so is the existence of an undisclosed principal except where nondisclosure of the principal would constitute fraud.

Crime or Fraud by Client

[3] Under Rule 1.2(d), a lawyer is prohibited from counseling or assisting a client in conduct that the lawyer knows is criminal or fraudulent. Paragraph (b) states a specific application of the principle set forth in Rule 1.2(d) and addresses the situation where a client's crime or fraud takes the form of a lie or misrepresentation. Ordinarily, a lawyer can avoid assisting a client's crime or fraud by withdrawing from the representation. Sometimes it may be necessary for the lawyer to give notice of the fact of withdrawal and to disaffirm an opinion, document, affirmation or the like. In extreme cases, substantive law may require a lawyer to disclose information relating to the representation to avoid being deemed to have assisted the client's crime or fraud. If the lawyer can avoid assisting a client's crime or fraud only by disclosing this information, then under paragraph (b) the lawyer is required to do so, unless the disclosure is prohibited by Rule 1.6. Rule

1.6 permits a lawyer to disclose information when necessary to prevent or rectify certain crimes or frauds. See Rule 1.6(c). If disclosure is permitted by Rule 1.6, then such disclosure is required under this Rule, but only to the extent necessary to avoid assisting a client crime or fraud.

Rule 4.2 Communication with Person Represented by Counsel

In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order.

Comment:

[1] This Rule contributes to the proper functioning of the legal system by protecting a person who has chosen to be represented by a lawyer in a matter against possible overreaching by other lawyers who are participating in the matter, interference by those lawyers with the client-lawyer relationship and the uncounselled disclosure of information relating to the representation.

[2] This Rule applies to communications with any person who is represented by counsel concerning the matter to which the communication relates.

[3] The Rule applies even though the represented person initiates or consents to the communication. A lawyer must immediately terminate communication with a person if, after commencing communication, the lawyer learns that the person is one with whom communication is not permitted by this Rule.

[4] This Rule does not prohibit communication with a represented person, or an employee or agent of such a person, concerning matters outside the representation. For example, the existence of a controversy between a government agency and a private party, or between two organizations, does not prohibit a lawyer for either from communicating with nonlawyer representatives of the other regarding a separate matter. Nor does this Rule preclude communication with a represented person who is seeking advice from a lawyer who is not otherwise representing a client in the matter. A lawyer may not make a communication prohibited by this Rule through the acts of another. See Rule 8.4(a). Parties to a matter may communicate directly with each other, and a lawyer is not prohibited from advising a client concerning a communication that the client is legally entitled to make. Also, a lawyer having independent justification or legal authorization for communicating with a represented person is permitted to do so.

[5] Communications authorized by law may include communications by a lawyer on behalf of a client who is exercising a constitutional or other legal right to communicate with the government. Communications authorized by law may also include constitutionally permissible investigative activities of lawyers representing governmental entities, directly or through investigative agents, prior to the commencement of criminal or civil enforcement proceedings. When communicating with the accused in a criminal matter, a government lawyer must comply with this Rule in addition to honoring the constitutional rights of the accused. The fact that a communication does not violate a state or federal constitutional right is insufficient to establish that the communication is permissible under this Rule.

[6] A lawyer who is uncertain whether a communication with a represented person is permissible may seek a court order. A lawyer may also seek a court order in exceptional circumstances to authorize a communication that would otherwise be prohibited by this Rule, for example, where communication with a person represented by counsel is necessary to avoid reasonably certain injury.

[7] In the case of a represented organization, this Rule prohibits communications with a constituent of the organization who supervises, directs or regularly consults with the organization's lawyer concerning the matter or has authority to obligate the organization with respect to the matter or whose act or omission in connection with the matter may be imputed to the organization for purposes of civil or criminal liability. Consent of the organization's lawyer is not required for communication with a former constituent. If a constituent of the organization is represented in the matter by his or her own counsel, the consent by that counsel to a communication will be sufficient for purposes of this Rule. Compare Rule 3.4(f). In communicating with a current or former constituent of an organization, a lawyer must not use methods of obtaining evidence that violate the legal rights of the organization. See Rule 4.4.

[8] The prohibition on communications with a represented person only applies in circumstances where the lawyer knows that the person is in fact represented in the matter to be discussed. This means that the lawyer has actual knowledge of the fact of the representation; but such actual knowledge may be inferred from the circumstances. See Rule 1.0(f). Thus, the lawyer cannot evade the requirement of obtaining the consent of counsel by closing eyes to the obvious.

[9] In the event the person with whom the lawyer communicates is not known to be represented by counsel in the matter, the lawyer's communications are subject to Rule 4.3.

Rule 4.3 Dealing with Unrepresented Person

(a) In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested.

(b) During the course of a lawyer's representation of a client, a lawyer shall not give advice to a person who is not represented by a lawyer, other than the advice to secure counsel, if the lawyer knows or reasonably should know the interests of such person are or have a reasonable possibility of being in conflict with the interests of the lawyer's client.

(c) When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer should make reasonable efforts to correct the misunderstanding.

Comment:

[1] An unrepresented person, particularly one not experienced in dealing with legal matters, might assume that a lawyer is disinterested in loyalties or is a disinterested authority on the law even when the lawyer represents a client. In order to avoid a misunderstanding, a lawyer will typically need to identify the lawyer's client and, where necessary, explain that the client has interests opposed to those of the unrepresented person. For misunderstandings that sometimes arise when a lawyer for an organization deals with an unrepresented constituent, see Rule 1.13(d).

[2] The Rule distinguishes between situations involving unrepresented persons whose interests may be adverse to those of the lawyer's client and those in which the person's interests are not in conflict with the client's. In the former situation, the possibility that the lawyer will compromise the unrepresented person's interests is so great that the Rule prohibits the giving of any advice, apart from the advice to obtain counsel. Whether a lawyer is giving impermissible advice may depend on the experience and sophistication of the unrepresented person, as well as the setting in which the behavior and comments occur. This Rule does not prohibit a lawyer from negotiating the terms of a transaction or settling a dispute with an unrepresented person. So long as the lawyer has explained that the lawyer represents an adverse party and is not representing the person, the lawyer may inform the person of the terms on which the lawyer's client will enter into an agreement or settle a matter, prepare documents that require the person's signature and explain the lawyer's own view of the meaning of the document or the lawyer's view of the underlying legal obligations.

Rule 4.4 Respect for Rights of Third Persons

(a) In representing a client, a lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person, or use methods of obtaining evidence that violate the legal rights of such a person.

(b) A lawyer who receives a document, including electronically stored information, relating to the representation of the lawyer's client and knows or reasonably should know that the document, including electronically stored information, was inadvertently sent shall promptly notify the sender.

Comment:

[1] Responsibility to a client requires a lawyer to subordinate the interests of others to those of the client, but that responsibility does not imply that a lawyer may disregard the rights of third persons. It is

impractical to catalogue all such rights, but they include legal restrictions on methods of obtaining evidence from third persons and unwarranted intrusions into privileged relationships, such as the client-lawyer relationship.

[2] Paragraph (b) recognizes that lawyers sometimes receive a document, including electronically stored information, that was mistakenly sent or produced by opposing parties or their lawyers. A document, including electronically stored information, is inadvertently sent when it is accidentally transmitted, such as when an email or letter is misaddressed or a document, including electronically stored information, is accidentally included with information that was intentionally transmitted. If a lawyer knows or reasonably should know that such a document, including electronically stored information, was sent inadvertently, then this Rule requires the lawyer to promptly notify the sender in order to permit that person to take protective measures. Whether the lawyer is required to take additional steps, such as returning the document, including electronically stored information, is a matter of law beyond the scope of these Rules, as is the question of whether the privileged status of a document, including electronically stored information, has been waived. Similarly, this Rule does not address the legal duties of a lawyer who receives a document, including electronically stored information, that the lawyer knows or reasonably should know may have been inappropriately obtained by the sending person. For purposes of this Rule, "document, including electronically stored information" includes, in addition to paper documents, email and other forms of electronically stored information, including embedded data (commonly referred to as "metadata"), that is subject to being read or put into readable form. Metadata in electronic documents creates an obligation under this Rule only if the receiving lawyer knows or reasonably should know that the metadata was inadvertently sent to the receiving lawyer.

[3] Some lawyers may choose to return a document or delete electronically stored information unread, for example, when the lawyer learns before receiving it that it was inadvertently sent. Where a lawyer is not required by applicable law to do so, the decision to voluntarily return such a document or delete electronically stored information is a matter of professional judgment ordinarily reserved to the lawyer. See Rules 1.2 and 1.4.

LAW FIRMS AND ASSOCIATIONS

Rule 5.1 Responsibilities of Partners, Managers and Supervisory Lawyers

(a) A partner in a law firm, and a lawyer who individually or together with other lawyers possesses comparable managerial authority in a law firm, shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct.

(b) A lawyer having direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct.

(c) A lawyer shall be responsible for another lawyer's violation of the Rules of Professional Conduct if:

(1) the lawyer orders or, with knowledge of the specific conduct, ratifies the conduct involved; or

(2) the lawyer is a partner or has comparable managerial authority in the law firm in which the other lawyer practices, or has direct supervisory authority over the other lawyer, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

Comment:

[1] Paragraph (a) applies to lawyers who have managerial authority over the professional work of a firm. See Rule 1.0(c). This includes members of a partnership, the shareholders in a law firm organized as a professional corporation, and members of other associations authorized to practice law; lawyers having comparable managerial authority in a legal services organization or a law department of an enterprise or government agency; and lawyers who have intermediate managerial responsibilities in a firm. Paragraph (b) applies to lawyers who have supervisory authority over the work of other lawyers in a firm.

[2] Paragraph (a) requires lawyers with managerial authority within a firm to make reasonable efforts to establish internal policies and procedures designed to provide reasonable assurance that all lawyers in the firm will conform to the Rules of Professional Conduct. Such policies and procedures include those designed to detect and resolve conflicts of interest, identify dates by which actions must be taken in pending matters, account for client funds and property and ensure that inexperienced lawyers are properly supervised.

[3] Other measures that may be required to fulfill the responsibility prescribed in paragraph (a) can depend on the firm's structure and the nature of its practice. In a small firm of experienced lawyers, informal supervision and periodic review of compliance with the required systems ordinarily will suffice. In a large firm, or in practice situations in which difficult ethical problems frequently arise, more elaborate measures may be necessary. Some firms, for example, have a procedure whereby junior lawyers can make confidential referral of ethical problems directly to a designated senior partner or special committee. See Rule 5.2. Firms, whether large or small, may also rely on continuing legal education in professional ethics. In any event, the ethical atmosphere of a firm can influence the conduct of all its members and the partners may not assume that all lawyers associated with the firm will inevitably conform to the Rules.

[4] Paragraph (c) expresses a general principle of personal responsibility for acts of another. See also Rule 8.4(a).

[5] Paragraph (c)(2) defines the duty of a partner or other lawyer having comparable managerial authority in a law firm, as well as a lawyer who has direct supervisory authority over performance of specific legal work by another lawyer. Whether a lawyer has supervisory authority in particular circumstances is a question of fact. Partners and lawyers with comparable authority have at least indirect responsibility for all work being done by the firm, while a partner or manager in charge of a particular matter ordinarily also has supervisory responsibility for the work of other firm lawyers engaged in the matter. Appropriate remedial action by a partner or managing lawyer would depend on the immediacy of that lawyer's involvement and the seriousness of the misconduct. A supervisor is required to intervene to prevent avoidable consequences of misconduct if the supervisor knows that the misconduct occurred. Thus, if a supervising lawyer knows that a subordinate misrepresented a matter to an opposing party in negotiation, the supervisor as well as the subordinate has a duty to correct the resulting misapprehension.

[6] Professional misconduct by a lawyer under supervision could reveal a violation of paragraph (b) on the part of the supervisory lawyer even though it does not entail a violation of paragraph (c) because there was no direction, ratification or knowledge of the violation.

[7] Apart from this Rule and Rule 8.4(a), a lawyer does not have disciplinary liability for the conduct of a partner, associate or subordinate. Whether a lawyer may be liable civilly or criminally for another lawyer's conduct is a question of law beyond the scope of these Rules.

[8] The duties imposed by this Rule on managing and supervising lawyers do not alter the personal duty of each lawyer in a firm to abide by the Rules of Professional Conduct. See Rule 5.2(a).

Rule 5.2 Responsibilities of a Subordinate Lawyer

(a) A lawyer is bound by the Rules of Professional Conduct notwithstanding that the lawyer acts at the direction of another person.

(b) A subordinate lawyer does not violate the Rules of Professional Conduct if that lawyer acts in accordance with a supervisory lawyer's reasonable resolution of an arguable question of professional duty.

Comment:

[1] Although a lawyer is not relieved of responsibility for a violation by the fact that the lawyer acted at the direction of a supervisor, that fact may be relevant in determining whether a lawyer had the knowledge required to render conduct a violation of the Rules. For example, if a subordinate filed a frivolous pleading at the direction of a supervisor, the subordinate would not be guilty of a professional violation unless the subordinate knew of the document's frivolous character.

[2] When lawyers in a supervisor-subordinate relationship encounter a matter involving professional judgment as to ethical duty, the supervisor may assume responsibility for making the judgment. Otherwise a consistent course of action or position could not be taken. If the question can reasonably be answered only one way, the duty of both lawyers is clear and they are equally responsible for fulfilling it. However, if the question is reasonably arguable, someone has to decide upon the course of action. That authority ordinarily reposes in the supervisor, and a subordinate may be guided accordingly. For example, if a question arises whether the interests of two clients conflict under Rule 1.7, the supervisor's reasonable resolution of the question should protect the subordinate professionally if the resolution is subsequently challenged.

Rule 5.3 Responsibilities Regarding Nonlawyer Assistance

With respect to a nonlawyer employed or retained by or associated with a lawyer:

(a) a partner and a lawyer who individually or together with other lawyers possesses comparable managerial authority in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the person's conduct is compatible with the professional obligations of the lawyer.

(b) a lawyer having direct supervisory authority over the nonlawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer; and,

(c) a lawyer shall be responsible for conduct of such a person that would be a violation of the Rules of Professional Conduct if engaged in by a lawyer if:

(1) the lawyer orders or, with the knowledge of the specific conduct, ratifies the conduct involved; or

(2) the lawyer is a partner or has comparable managerial authority in the law firm in which the person is employed, or has direct supervisory authority over the person, and in either case knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

Comment:

[1] Paragraph (a) requires lawyers with managerial authority within a law firm to make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that nonlawyers in the firm and nonlawyers outside the firm who work on firm matters act in a way compatible with the professional obligations of the lawyer. See Comment [6] to Rule 1.1 and Comment [1] to Rule 5.1. Paragraph (b) applies to lawyers who have supervisory authority over such nonlawyers within or outside the firm. Paragraph (c) specifies the circumstances in which a lawyer is responsible for the conduct of such nonlawyers within or outside the firm that would be a violation of the Rules of Professional Conduct if engaged in by a lawyer.

Nonlawyers Within the Firm

[2] Lawyers generally employ assistants in their practice, including secretaries, investigators, law student interns, and paraprofessionals. Such assistants, whether employees or independent contractors, act for the lawyer in rendition of the lawyer's professional services. A lawyer must give such assistants appropriate instruction and supervision concerning the ethical aspects of their employment, particularly regarding the obligation not to disclose information relating to representation of the client, and should be responsible for their work product. The measures employed in supervising nonlawyers should take account of the fact that they do not have legal training and are not subject to professional discipline.

Nonlawyers Outside the Firm

[3] A lawyer may use nonlawyers outside the firm to assist the lawyer in rendering legal services to the client. Examples include the retention of an investigative or paraprofessional service, hiring a document management company to create and maintain a database for complex litigation, sending client documents to a third party for printing or scanning, and using an Internet-based service to store client information. When

using such services outside the firm, a lawyer must make reasonable efforts to ensure that the services are provided in a manner that is compatible with the lawyer's professional obligations. The extent of this obligation will depend upon the circumstances, including the education, experience and reputation of the nonlawyer; the nature of the services involved; the terms of any arrangements concerning the protection of client information; and the legal and ethical environments of the jurisdictions in which the services will be performed, particularly with regard to confidentiality. See also Rules 1.1, 1.2, 1.4, 1.6, 5.4(a), and 5.5(a). When retaining or directing a nonlawyer outside the firm, a lawyer should communicate directions appropriate under the circumstances to give reasonable assurance that the nonlawyer's conduct is compatible with the professional obligations of the lawyer.

[4] Where the client directs the selection of a particular nonlawyer service provider outside the firm, the lawyer ordinarily should agree with the client concerning the allocation of responsibility for monitoring as between the client and the lawyer. See Rule 1.2. When making such an allocation in a matter pending before a tribunal, lawyers and parties may have additional obligations that are a matter of law beyond the scope of these Rules.

Rule 5.4 Professional Independence Of A Lawyer

(a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:

(1) an agreement by a lawyer with the lawyer's firm, partner, or associate may provide for the payment of money, over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons;

(2) a lawyer who undertakes to complete unfinished legal business of a deceased lawyer may pay to the estate of the deceased lawyer that portion of the total compensation which fairly represents the services rendered by the deceased lawyer;

(3) a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement;

(4) a lawyer or law firm may purchase the practice of another lawyer or law firm from an estate or other eligible person or entity consistent with Rule 1.17; and,

(5) a lawyer may share court-awarded legal fees with a nonprofit organization that employed, retained or recommended employment of the lawyer in the matter.

(b) A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.

(c) A lawyer shall not permit a person who recommends, employs or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

(d) A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for profit, if:

(1) a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of the lawyer for a reasonable time during administration;

(2) a nonlawyer is a corporate director or officer thereof or occupies the position of similar responsibility in any form of association other than a corporation;

(3) a nonlawyer has the right to direct or control the professional judgment of a lawyer; or,

(4) in the case of any form of association other than a professional corporation, the organic law governing the internal affairs of the association provides the equity owners of the association with greater liability protection than is available to the shareholders of a professional corporation.

Subparagraphs (1), (2), and (4) shall not apply to a lawyer employed in the legal department of a corporation or other organization.

Comment:

[1] The provisions of this Rule express traditional limitations on sharing fees. These limitations are to protect the lawyer's professional independence of judgment.

[2] Where someone other than the client pays the lawyer's fee or salary, or recommends employment of the lawyer, that arrangement does not modify the lawyer's obligation to the client. As stated in paragraph (c), such arrangements should not interfere with the lawyer's professional judgment.

[3] Paragraph (a)(4) incorporates the authorization for the sale of a law practice pursuant to Rule 1.17. Fees may be shared between a lawyer purchasing a law practice and the estate or representative of the lawyer when a law practice is sold.

[4] Paragraph (a)(5) adds a new dimension to the current Rule by specifically permitting sharing of fees with a nonprofit organization. It is a practice approved in ABA Formal Opinion 93-374.

[5] These Rules do not restrict the organization of a private law firm to certain specified forms, such as a general partnership or a professional corporation. It is permissible to organize a private law firm using any form of association desired, including, without limitations such nontraditional forms as a limited partnership, registered limited liability partnership, limited liability company or business trust, so long as all of the restrictions in paragraph (d) are satisfied.

[6] Paragraph (d)(1) recognizes that the owners of a private law firm may choose to organize their firm in such a way that it has more than one level of ownership such as, for example, a partnership composed of or including professional corporations. An ownership structure with more than one level will be permissible as long as all of the beneficial owners (as opposed to record owners) are lawyers, subject to the exception for estate administration.

[7] Underlying the restriction in paragraph (d)(4) is a recognition that there are a variety of organizational forms that may be used by a law firm that provide some level of protection from personal liability for their owners. The use of such a form of organization is permissible so long as the limitation on liability provided by that form is no more extensive than that available through the professional corporation form. See 15 Pa.C.S. § 2925. Implicit in paragraph (d)(4) is a recognition that, so long as the owners have the personal liability preserved by the professional corporation law, a limitation on other personal liability is appropriate and should be respected. The result in *First Bank & Trust Co. v. Zagoria*, 250 Ga. 844, 302 S.E.2d 674 (1983), and similar cases is rejected.

[8] Although the last sentence of subsection (d) recognizes that the restrictions in paragraph (d)(1), (2) and (4) are not properly applicable to a lawyer employed in the legal department of a corporation or other organization, it is still important to preserve the professional independence of a lawyer in that situation and thus the restriction in paragraph (d)(3) will apply to such a lawyer.

Rule 5.5 Unauthorized Practice of Law; Multijurisdictional Practice Of Law

(a) A lawyer shall not practice law in a jurisdiction in violation of the regulation of the legal profession in that jurisdiction, or assist another in doing so.

(b) A lawyer who is not admitted to practice in this jurisdiction shall not:

(1) except as authorized by these Rules, Pa.B.A.R. 302 or other law, establish an office or other systematic and continuous presence in this jurisdiction for the practice of law; or

(2) hold out to the public or otherwise represent that the lawyer is admitted to practice law in this jurisdiction.

(c) A lawyer admitted in another United States jurisdiction or in a foreign jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may provide legal services on a temporary basis in this jurisdiction that:

(1) are undertaken in association with a lawyer who is admitted to practice in this jurisdiction and who actively participates in the matter;

(2) are in or reasonably related to a pending or potential proceeding before a tribunal in this or another jurisdiction, if the lawyer, or a person the lawyer is assisting, is authorized by law or order to appear in such proceeding or reasonably expects to be so authorized;

(3) are in or reasonably related to a pending or potential arbitration, mediation, or other alternative dispute resolution proceeding in this or another jurisdiction, if the services arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice and are not services for which the forum requires pro hac vice admission; or

(4) are not within paragraphs (c)(2) or (c)(3) and arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice.

(d) A lawyer admitted in another United States jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may, subject to the requirements of Pa.B.A.R. 302, provide legal services in this jurisdiction that:

(1) are provided to the lawyer's employer or its organizational affiliates and are not services for which the forum requires pro hac vice admission, except that this paragraph (d) does not authorize a lawyer who is not admitted in this jurisdiction and who is employed by the Commonwealth, any of its political subdivisions or any of their organizational affiliates to provide legal services in this jurisdiction; or,

(2) are services that the lawyer is authorized to provide by federal law or other law of this jurisdiction.

Comment:

[1] A lawyer may practice law only in a jurisdiction in which the lawyer is authorized to practice. A lawyer may be admitted to practice law in a jurisdiction on a regular basis or may be authorized by court rule or order or by law to practice for a limited purpose or on a restricted basis. Paragraph (a) applies to unauthorized practice of law by a lawyer, whether through the lawyer's direct action or by the lawyer assisting another person. For example, a lawyer may not assist a person in practicing law in violation of the rules governing professional conduct in that person’s jurisdiction.

[2] The definition of the practice of law is established by law and varies from one jurisdiction to another. Whatever the definition, limiting the practice of law to members of the bar protects the public against rendition of legal services by unqualified persons. This Rule does not prohibit a lawyer from employing the services of paraprofessionals and delegating functions to them, so long as the lawyer supervises the delegated work and retains responsibility for their work. See Rule 5.3.

[3] A lawyer may provide professional advice and instruction to nonlawyers whose employment requires knowledge of the law; for example, claims adjusters, employees of financial or commercial institutions, social workers, accountants and persons employed in government agencies. Lawyers also may assist independent nonlawyers, such as paraprofessionals, who are authorized by the law of a jurisdiction to provide particular law-related services. In addition, a lawyer may counsel nonlawyers who wish to proceed pro se.

[4] Other than as authorized by law or this Rule, a lawyer who is not admitted to practice generally in this jurisdiction violates paragraph (b) if the lawyer establishes an office or other systematic and continuous presence in this jurisdiction for the practice of law. Presence may be systematic and continuous even if the

lawyer is not physically present here. Such a lawyer must not hold out to the public or otherwise represent that the lawyer is admitted to practice law in this jurisdiction. See also Rules 7.1(a) and 7.5(b).

[5] There are occasions in which lawyers admitted to practice in another foreign or United States jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may provide legal services on a temporary basis in this jurisdiction under circumstances that do not create an unreasonable risk to the interests of their clients, the public or the courts. Paragraph (c) identifies four such circumstances. The fact that conduct is not so identified does not imply that the conduct is or is not authorized. With the exception of paragraphs (d)(1) and (d)(2), this Rule does not authorize a lawyer to establish an office or other systematic and continuous presence in this jurisdiction without being admitted to practice generally here.

[6] There is no single test to determine whether a lawyer's services are provided on a "temporary basis" in this jurisdiction, and may therefore be permissible under paragraph (c). Services may be "temporary" even though the lawyer provides services in this jurisdiction on a recurring basis, or for an extended period of time, as when the lawyer is representing a client in a single lengthy negotiation or litigation.

[7] Paragraphs (c) and (d) apply to lawyers who are admitted to practice law in any foreign or United States jurisdiction, which includes the District of Columbia and any state, territory or commonwealth of the United States. It is also intended to allow military lawyers to practice law on a pro bono basis for members of the military in civil matters. The word "admitted" in paragraph (c) contemplates that the lawyer is authorized to practice in the jurisdiction in which the lawyer is admitted and excludes a lawyer who while technically admitted is not authorized to practice, because, for example, the lawyer is on inactive status.

[8] Paragraph (c)(1) recognizes that the interests of clients and the public are protected if a lawyer admitted only in another jurisdiction associates with a lawyer licensed to practice in this jurisdiction. For this paragraph to apply, however, the lawyer admitted to practice in this jurisdiction must actively participate in and share responsibility for the representation of the client.

[9] Lawyers not admitted to practice generally in a jurisdiction may be authorized by law or order of a tribunal or an administrative agency to appear before the tribunal or agency. This authority may be granted pursuant to formal rules governing admission pro hac vice or pursuant to informal practice of the tribunal or agency. Under paragraph (c)(2), a lawyer does not violate this Rule when the lawyer appears before a tribunal or agency pursuant to such authority. To the extent that a court rule or other law of this jurisdiction requires a lawyer who is not admitted to practice in this jurisdiction to obtain admission pro hac vice before appearing before a tribunal or administrative agency, this Rule requires the lawyer to obtain that authority.

[10] Paragraph (c)(2) also provides that a lawyer rendering services in this jurisdiction on a temporary basis does not violate this Rule when the lawyer engages in conduct in anticipation of a proceeding or hearing in a jurisdiction in which the lawyer is authorized to practice law or in which the lawyer reasonably expects to be admitted pro hac vice. Examples of such conduct include meetings with the client, interviews of potential witnesses, and the review of documents. Similarly, a lawyer admitted only in another jurisdiction may engage in conduct temporarily in this jurisdiction in connection with pending litigation in another jurisdiction in which the lawyer is or reasonably expects to be authorized to appear, including taking depositions in this jurisdiction.

[11] When a lawyer has been or reasonably expects to be admitted to appear before a court or administrative agency, paragraph (c)(2) also permits conduct by lawyers who are associated with that lawyer in the matter, but who do not expect to appear before the court or administrative agency. For example, subordinate lawyers may conduct research, review documents, and attend meetings with witnesses in support of the lawyer responsible for the litigation.

[12] Paragraph (c)(3) permits a lawyer admitted to practice law in another jurisdiction to perform services on a temporary basis in this jurisdiction if those services are in or reasonably related to a pending or potential arbitration, mediation, or other alternative dispute resolution proceeding in this or another jurisdiction, if the services arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice. The lawyer, however, must obtain admission pro hac vice in the case of a court-annexed arbitration or mediation or otherwise if court rules or law so require.

[13] Paragraph (c)(4) permits a lawyer admitted in another jurisdiction to provide certain legal services on a temporary basis in this jurisdiction that arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted but are not within paragraphs (c)(2) or (c)(3). These

services include both legal services and services that non-lawyers may perform but that are considered the practice of law when performed by lawyers.

[14] Paragraphs (c)(3) and (c)(4) require that the services arise out of or be reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted. A variety of factors evidence such a relationship. The lawyer's client may have been previously represented by the lawyer, or may be resident in or have substantial contacts with the jurisdiction in which the lawyer is admitted. The matter, although involving other jurisdictions, may have a significant connection with that jurisdiction. In other cases, significant aspects of the lawyer's work might be conducted in that jurisdiction or a significant aspect of the matter may involve the law of that jurisdiction. The necessary relationship might arise when the client's activities or the legal issues involve multiple jurisdictions, such as when the officers of a multinational corporation survey potential business sites and seek the services of their lawyer in assessing the relative merits of each. In addition, the services may draw on the lawyer's recognized expertise developed through the regular practice of law on behalf of clients in matters involving a particular body of federal, nationally-uniform, foreign, or international law.

[15] Paragraph (d) identifies two circumstances in which a lawyer who is admitted to practice in another jurisdiction, and is not disbarred or suspended from practice in any jurisdiction, may establish an office or other systematic and continuous presence in this jurisdiction for the practice of law as well as provide legal services on a temporary basis. Except as provided in paragraphs (d)(1) and (d)(2), a lawyer who is admitted to practice law in another jurisdiction and who establishes an office or other systematic or continuous presence in this jurisdiction must become admitted to practice law generally in this jurisdiction.

[16] Paragraph (d)(1) applies to a lawyer who is employed by a client to provide legal services to the client or its organizational affiliates, i.e., entities that control, are controlled by, or are under common control with the employer. This paragraph does not authorize the provision of personal legal services to the employer's officers or employees. The paragraph applies to in-house corporate lawyers, government lawyers and others who are employed to render legal services to the employer. The lawyer's ability to represent the employer outside the jurisdiction in which the lawyer is licensed generally serves the interests of the employer and does not create an unreasonable risk to the client and others because the employer is well situated to assess the lawyer's qualifications and the quality of the lawyer's work. A lawyer employed by the Commonwealth or one of its organizational affiliates, however, is not entitled to the exemption provided by paragraph (d) with respect to legal services provided in this jurisdiction. In the relatively rare instance that a lawyer employed by the Commonwealth or an organizational affiliate only provides legal services outside of the Commonwealth, paragraph (d) will be applicable and the lawyer will not be required to be admitted in this jurisdiction. But in most instances, lawyers employed by the Commonwealth or one of its organizational affiliates must be admitted in this jurisdiction.

[17] If an employed lawyer establishes an office or other systematic presence in this jurisdiction for the purpose of rendering legal services to the employer, the lawyer may be subject to registration or other requirements, including assessments for client protection funds and mandatory continuing legal education.

[18] Paragraph (d)(2) recognizes that a lawyer may provide legal services in a jurisdiction in which the lawyer is not licensed when authorized to do so by federal or other law, which includes statute, court rule, executive regulation or judicial precedent.

[19] A lawyer who practices law in this jurisdiction pursuant to paragraphs (c) or (d) or otherwise is subject to the disciplinary authority of this jurisdiction. See Rule 8.5(a).

[20] In some circumstances, a lawyer who practices law in this jurisdiction pursuant to paragraphs (c) or (d) may have to inform the client that the lawyer is not licensed to practice law in this jurisdiction. For example, that may be required when the representation occurs primarily in this jurisdiction and requires knowledge of the law of this jurisdiction. See Rule 1.4(b).

[21] Paragraphs (c) and (d) do not authorize communications advertising legal services to prospective clients in this jurisdiction by lawyers who are admitted to practice in other jurisdictions. Whether and how lawyers may communicate the availability of their services to prospective clients in this jurisdiction is governed by Rules 7.1 to 7.5.

Rule 5.6 Restrictions on Right to Practice

A lawyer shall not participate in offering or making:

(a) a partnership, shareholders, operating, employment, or other similar type of agreement that restricts the right of a lawyer to practice after termination of the relationship, except an agreement concerning benefits upon retirement or an agreement for the sale of a law practice consistent with Rule 1.17; or

(b) an agreement in which a restriction on the lawyer's right to practice is part of the settlement of a client controversy.

Comment:

[1] An agreement restricting the right of lawyers to practice after leaving a firm not only limits their professional autonomy but also limits the freedom of clients to choose a lawyer. Paragraph (a) prohibits such agreements except for restrictions incident to provisions concerning retirement benefits for service with the firm.

[2] Paragraph (b) prohibits a lawyer from agreeing not to represent other persons in connection with settling a claim on behalf of a client.

[3] This Rule does not apply to prohibit restrictions that may be included in the terms of the sale of a law practice pursuant to Rule 1.17.

Rule 5.7 Responsibilities Regarding Nonlegal Services

(a) A lawyer who provides nonlegal services to a recipient that are not distinct from legal services provided to that recipient is subject to the Rules of Professional Conduct with respect to the provision of both legal and nonlegal services.

(b) A lawyer who provides nonlegal services to a recipient that are distinct from any legal services provided to the recipient is subject to the Rules of Professional Conduct with respect to the nonlegal services if the lawyer knows or reasonably should know that the recipient might believe that the recipient is receiving the protection of a client-lawyer relationship.

(c) A lawyer who is an owner, controlling party, employee, agent, or is otherwise affiliated with an entity providing nonlegal services to a recipient is subject to the Rules of Professional Conduct with respect to the nonlegal services if the lawyer knows or reasonably should know that the recipient might believe that the recipient is receiving the protection of a client-lawyer relationship.

(d) Paragraph (b) or (c) does not apply if the lawyer makes reasonable efforts to avoid any misunderstanding by the recipient receiving nonlegal services. Those efforts must include advising the recipient that the services are not legal services and that the protection of a client-lawyer relationship does not exist with respect to the provision of nonlegal services to the recipient.

(e) The term "nonlegal services" denotes services that might reasonably be performed in conjunction with and in substance are related to the provision of legal services, and that are not prohibited as unauthorized practice of law when provided by a nonlawyer.

Comment:

[1] For many years, lawyers have provided to their clients nonlegal services that are ancillary to the practice of law. Examples of nonlegal services include providing title insurance, financial planning, accounting, trust services, real estate counseling, legislative lobbying, economic analysis, social work, psychological counseling, tax return preparation, and patent, medical or environmental consulting. A broad range of economic and other interests of clients may be served by lawyers participating in the delivery of these services.

The Potential for Misunderstanding

[2] Whenever a lawyer directly provides nonlegal services, there exists the potential for ethical problems. Principal among these is the possibility that the person for whom the nonlegal services are performed may fail to understand that the services may not carry with them the protection normally afforded by the client-lawyer relationship. The recipient of the nonlegal services may expect, for example, that the protection of client confidences, prohibitions against representation of persons with conflicting interests, and obligations of a lawyer to maintain professional independence apply to the provision of nonlegal services when that may not be the case. The risk of such confusion is especially acute when the lawyer renders both types of services with respect to the same matter.

Providing Nonlegal Services that Are Not Distinct from Legal Services

[3] Under some circumstances, the legal and nonlegal services may be so closely entwined that they cannot be distinguished from each other. In this situation, confusion by the recipient as to when the protection of the client-lawyer relationship applies is likely to be unavoidable. Therefore, Rule 5.7(a) requires that the lawyer providing the nonlegal services adhere to all of the requirements of the Rules of Professional Conduct.

[4] In such a case, a lawyer will be responsible for assuring that both the lawyer's conduct and, to the extent required by Rule 5.3, that of nonlawyer employees, comply in all respects with the Rules of Professional Conduct. When a lawyer is obliged to accord the recipients of such nonlegal services the protection of those Rules that apply to the client-lawyer relationship, the lawyer must take special care to heed the proscriptions of the Rules addressing conflict of interest (Rules 1.7 through 1.11, especially Rules 1.7(b) and 1.8(a), (b) and (f)), and to scrupulously adhere to the requirements of Rule 1.6 relating to disclosure of confidential information. The promotion of the nonlegal services must also in all respects comply with Rule 5.8 relating to prohibitions and restrictions on dealing in investment products, and with Rules 7.1 through 7.3, dealing with advertising and solicitation.

[5] Rule 5.7(a) applies to the provision of nonlegal services by a lawyer even when the lawyer does not personally provide any legal services to the person for whom the nonlegal services are performed if the person is also receiving legal services from another lawyer that are not distinct from the nonlegal services.

Avoiding Misunderstanding when a Lawyer Directly Provides Nonlegal Services that Are Distinct from Legal Services

[6] Even when the lawyer believes that his or her provision of nonlegal services is distinct from any legal services provided to the recipient, there is still a risk that the recipient of the nonlegal services will misunderstand the implications of receiving nonlegal services from a lawyer; the recipient might believe that the recipient is receiving the protection of a client-lawyer relationship. Where there is such a risk of misunderstanding, Rule 5.7(b) requires that the lawyer providing the nonlegal services adhere to all the Rules of Professional Conduct, unless exempted by Rule 5.7(d).

Avoiding Misunderstanding when a Lawyer Is Indirectly Involved in the Provision of Nonlegal Services

[7] Nonlegal services also may be provided through an entity with which a lawyer is somehow affiliated, for example, as owner, employee, controlling party or agent. In this situation, there is still a risk that the recipient of the nonlegal services might believe that the recipient is receiving the protection of a client-lawyer relationship. Where there is such a risk of misunderstanding, Rule 5.7(c) requires that the lawyer involved with the entity providing nonlegal services adhere to all the Rules of Professional Conduct, unless exempted by Rule 5.7(d).

Avoiding the Application of Paragraphs (b) and (c)

[8] Paragraphs (b) and (c) specify that the Rules of Professional Conduct apply to a lawyer who directly provides or is otherwise involved in the provision of nonlegal services if there is a risk that the recipient might believe that the recipient is receiving the protection of a client-lawyer relationship. Neither the Rules of Professional Conduct nor paragraphs (b) or (c) will apply, however, if pursuant to paragraph (d), the lawyer takes reasonable efforts to avoid any misunderstanding by the recipient. In this respect, Rule 5.7 is analogous to Rule 4.3(c).

[9] In taking the reasonable measures referred to in paragraph (d), the lawyer must communicate to the person receiving the nonlegal services that the relationship will not be a client-lawyer relationship. The communication should be made before entering into an agreement for the provision of nonlegal services, in a manner sufficient to assure that the person understands the significance of the communication, and preferably should be in writing.

[10] The burden is upon the lawyer to show that the lawyer has taken reasonable measures under the circumstances to communicate the desired understanding. For instance, a sophisticated user of nonlegal services, such as a publicly-held corporation, may require a lesser explanation than someone unaccustomed to making distinctions between legal services and nonlegal services, such as an individual seeking tax advice from a lawyer-accountant or investigative services in connection with a lawsuit.

The Relationship Between Rule 5.7 and Other Rules of Professional Conduct

[11] Even before Rule 5.7 was adopted, a lawyer involved in the provision of nonlegal services was subject to those Rules of Professional Conduct that apply generally. For example, Rule 8.4(c) makes a lawyer responsible for fraud committed with respect to the provision of nonlegal services. Such a lawyer must also comply with Rule 1.8(a). Nothing in this rule is intended to suspend the effect of any otherwise applicable Rule of Professional Conduct such as Rule 1.7(b), Rule 1.8(a) and Rule 8.4(c).

[12] In addition to the Rules of Professional Conduct, principles of law external to the Rules, for example, the law of principal and agent, may govern the legal duties owed by a lawyer to those receiving the nonlegal services.

Rule 5.8 Dealing in Investment Products: Prohibitions and Restrictions

(a) A lawyer shall not broker, offer to sell, sell, or place any investment product unless separately licensed to do so.

(b) A lawyer shall not recommend or offer an investment product to a client or any person with whom the lawyer has a fiduciary relationship, or invest funds belonging to such a person in an investment product, if the lawyer or a person related to the lawyer:

(1) has an interest in compensation paid or provided by a person other than the client or person with whom the lawyer has a fiduciary relationship; or,

(2) has an ownership interest in the entity that sponsors, insures, underwrites, manages, or issues the investment product.

(c) For purposes of this Rule:

(1) the term "investment product" includes: an annuity contract; a life insurance contract; a commodity; a swap; an investment fund, including but not limited to a collective trust fund, a common trust fund, a real estate investment fund, and registered investment company; a security, whether or not the security is registered with any federal or state securities regulator; or an investment adviser's, bank's, trust company's, insurance company's, or other financial institution's service as an investment manager or investment adviser;

(2) "person related to the lawyer" includes a spouse, child, grandchild, parent, grandparent or other relative or individual with whom the lawyer maintains a close familial relationship; and,

(3) the term "ownership interest" does not include shares of an issuer that has registered the shares under federal securities laws, the issuer's shares are traded on a securities exchange that is registered under federal securities laws, and the lawyer's aggregate interest in shares of all classes is less than one percent of the issuer's outstanding common shares.

Comment:

[1] Paragraph (a) prohibits a lawyer from brokering, offering to sell, selling, or placing any investment product, as defined in paragraph (c)(1), unless separately licensed to do so. Licensing and

registration requirements vary by state. Before offering or selling any investment product in relation to the provision of legal services, a lawyer must consult all applicable federal and state laws to determine eligibility, licensing and regulatory requirements. Paragraph (a) neither addresses the giving of investment advice nor is intended to supplant or otherwise affect federal and state laws that either require licensing and registration in order to give investment advice or exempt lawyers from their regulatory scheme.

[2] Paragraph (b) prohibits investment situations that are fraught with a potential for a conflict of interest or that provide an opportunity for the lawyer to control or unduly influence the use or management of the funds throughout the course of the investment. Clients who place their trust in their lawyer and assume or expect that the lawyer will protect them from harm are likely to feel deceived if substantial sums of money are lost on investments pursued at the lawyer's recommendation or prompting and the lawyer or a person related to the lawyer either receives compensation or a pecuniary benefit from a person other than the client or has an ownership interest in the entity that sponsors, insures, underwrites, manages, or issues the investment product, even when the reason for the loss is limited to unexpected market conditions. The prohibition of paragraph (b) is not imputed to other lawyers in the lawyer's firm or those lawyers' relatives.

[3] This Rule applies to a lawyer under any circumstance—whether the lawyer is providing legal services, nonlegal services that are not distinct from legal services, or nonlegal services that are distinct from legal services. See Rule 5.7(e) for the meaning of the term "nonlegal services." The prohibition of paragraph (b) is in addition to the restrictions imposed by Rules 1.7(a)(2), 1.8(a), and 5.7.

PUBLIC SERVICE

Rule 6.1 Voluntary Pro Bono Publico Service

A lawyer should render public interest legal service. A lawyer may discharge this responsibility by providing professional services at no fee or a reduced fee to persons of limited means or to public service or charitable groups or organizations, by service in activities for improving the law, the legal system or the legal profession, and by financial support for organizations that provide legal services to persons of limited means.

Comment:

[1] The ABA House of Delegates has formally acknowledged "the basic responsibility of each lawyer engaged in the practice of law to provide public interest legal services" without fee, or at a substantially reduced fee, in one or more of the following areas: poverty law, civil rights law, public rights law, charitable organization representation and the administration of justice. This Rule expresses that policy but is not intended to be enforced through disciplinary process.

[2] The rights and responsibilities of individuals and organizations in the United States are increasingly defined in legal terms. As a consequence, legal assistance in coping with the web of statutes, rules and regulations is imperative for persons of modest and limited means, as well as for the relatively well-to-do.

[3] The basic responsibility for providing legal services for those unable to pay ultimately rests upon the individual lawyer, and personal involvement in the problems of the disadvantaged can be one of the most rewarding experiences in the life of a lawyer. Every lawyer, regardless of professional prominence or professional workload, should find time to participate in or otherwise support the provision of legal services to the disadvantaged. The provision of free legal services to those unable to pay reasonable fees continues to be an obligation of each lawyer as well as the profession generally, but the efforts of individual lawyers are often not enough to meet the need. Thus, it has been necessary for the profession and government to institute additional programs to provide legal services. Accordingly, legal aid offices, lawyer referral services and other related programs have been developed, and others will be developed by the profession and government. Every lawyer should support all proper efforts to meet this need for legal services.

[4] Law firms should act reasonably to enable and encourage all lawyers in the firm to provide the pro bono legal services called for by this Rule.

Rule 6.2 Accepting Appointments

A lawyer shall not seek to avoid appointment by a tribunal to represent a person except for good cause, such as:

(a) representing the client is likely to result in violation of the Rules of Professional Conduct or other law;

(b) representing the client is likely to result in an unreasonable financial burden on the lawyer; or,

(c) the client or the cause is so repugnant to the lawyer as to be likely to impair the client-lawyer relationship or the lawyer's ability to represent the client.

Comment:

[1] A lawyer ordinarily is not obliged to accept a client whose character or cause the lawyer regards as repugnant. The lawyer's freedom to select clients is, however, qualified. All lawyers have a responsibility to assist in providing pro bono publico service. See Rule 6.1. An individual lawyer fulfills this responsibility by accepting a fair share of unpopular matters or indigent or unpopular clients. A lawyer may also be subject to appointment by a court to serve unpopular clients or persons unable to afford legal services.

Appointed Counsel

[2] For good cause a lawyer may seek to decline an appointment to represent a person who cannot afford to retain counsel or whose cause is unpopular. Good cause exists if the lawyer could not handle the matter competently, see Rule 1.1, or if undertaking the representation would result in an improper conflict of interest, for example, when the client or the cause is so repugnant to the lawyer as to be likely to impair the client-lawyer relationship or the lawyer's ability to represent the client. A lawyer may also seek to decline an appointment if acceptance would be unreasonably burdensome, for example, when it would impose a financial sacrifice so great as to be unjust.

[3] An appointed lawyer has the same obligations to the client as retained counsel, including the obligations of loyalty and confidentiality, and is subject to the same limitations on the client-lawyer relationship, such as the obligation to refrain from assisting the client in violation of the Rules.

Rule 6.3 Membership in Legal Services Organization

A lawyer may serve as a director, officer or member of a legal services organization, apart from the law firm in which the lawyer practices, notwithstanding that the organization serves persons having interests adverse to a client of the lawyer. The lawyer shall not knowingly participate in a decision or action of the organization:

(a) if participating in the decision or action would be incompatible with the lawyer's obligations to a client under Rule 1.7; or,

(b) where the decision or action could have a material adverse effect on the representation of a client of the organization whose interests are adverse to a client of the lawyer.

Comment:

[1] Lawyers should be encouraged to support and participate in legal service organizations. A lawyer who is an officer or a member of such an organization does not thereby have a client-lawyer relationship with persons served by the organization. However, there is potential conflict between the interests of such persons and the interests of the lawyer's clients. If the possibility of such conflict disqualified a lawyer from serving on the board of a legal services organization, the profession's involvement in such organizations would be severely curtailed.

[2] It may be necessary in appropriate cases to reassure a client of the organization that the representation will not be affected by conflicting loyalties of a member of the board. Established, written policies in this respect can enhance the credibility of such assurances.

Rule 6.4 Law Reform Activities Affecting Client Interests

A lawyer may serve as a director, officer or member of an organization involved in reform of the law or its administration notwithstanding that the reform may affect the interests of a client of the lawyer. When the lawyer knows that the interests of a client may be materially benefited by a decision in which the lawyer participates, the lawyer shall disclose that fact but need not identify the client.

Comment:

[1] Lawyers involved in organizations seeking law reform generally do not have a client-lawyer relationship with the organization. Otherwise, it might follow that a lawyer could not be involved in a bar association law reform program that might indirectly affect a client. See also Rule 1.2(b). For example, a lawyer specializing in antitrust litigation might be regarded as disqualified from participating in drafting revisions of rules governing that subject. In determining the nature and scope of participation in such activities, a lawyer should be mindful of obligations to clients under other Rules, particularly Rule 1.7. A lawyer is professionally obligated to protect the integrity of the program by making an appropriate disclosure within the organization when the lawyer knows a private client might be materially benefited.

Rule 6.5 Nonprofit and Court Appointed Limited Legal Services Programs

(a) A lawyer who, under the auspices of a program sponsored by a nonprofit organization or court, provides short-term limited legal services to a client without expectation by either the lawyer or the client that the lawyer will provide continuing representation in the matter:

(1) is subject to Rules 1.7 and 1.9(a) only if the lawyer knows that the representation of the client involves a conflict of interest; and

(2) is subject to Rule 1.10 only if the lawyer knows that another lawyer associated with the lawyer in a law firm is disqualified by Rule 1.7 or 1.9(a) with respect to the matter.

(b) Except as provided in paragraph (a)(2), Rule 1.10 is inapplicable to a representation governed by this Rule.

Comment:

[1] Legal services organizations, courts and various nonprofit organizations have established programs through which lawyers provide short-term limited legal services – such as advice or the completion of legal forms – that will assist persons to address their legal problems without further representation by a lawyer. In these programs, such as legal-advice hotlines, advice-only clinics or pro se counseling programs, a client-lawyer relationship is established, but there is no expectation that the lawyer's representation of the client will continue beyond the limited consultation. Such programs are normally operated under circumstances in which it is not feasible for a lawyer to systematically screen for conflicts of interest as is generally required before undertaking a representation. See, e.g., Rules 1.7, 1.9, and 1.10.

[2] A lawyer who provides short-term limited legal services pursuant to this Rule must secure the client's informed consent to the limited scope of the representation. See Rule 1.2(c). If a short-term limited representation would not be reasonable under the circumstances, the lawyer may offer advice to the client but must also advise the client of the need for further assistance of counsel. Except as provided in this Rule, the Rules of Professional Conduct, including Rules 1.6 and 1.9(c), are applicable to the limited representation.

[3] Because a lawyer who is representing a client in the circumstances addressed by this Rule ordinarily is not able to check systematically for conflicts of interest, paragraph (a) requires compliance with Rules 1.7 or 1.9(a) only if the lawyer knows that the representation presents a conflict of interest for the lawyer, and with Rule 1.10 only if the lawyer knows that another lawyer in the lawyer's firm is disqualified by Rules 1.7 or 1.9(a) in the matter.

[4] Because the limited nature of the services significantly reduces the risk of conflicts of interest with other matters being handled by the lawyer's firm, paragraph (b) provides that Rule 1.10 is inapplicable to a representation governed by this Rule except as provided by paragraph (a)(2). Paragraph (a)(2) requires the participating lawyer to comply with Rule 1.10 when the lawyer knows that the lawyer's firm is disqualified by Rule 1.7 or 1.9(a). By virtue of paragraph (b), however, a lawyer's participation in a short-term limited legal services program will not preclude the lawyer's firm from undertaking or continuing the representation of a client with interests adverse to a client being represented under the program's auspices. Nor will the personal disqualification of a lawyer participating in the program be imputed to other lawyers participating in the program.

[5] If, after commencing a short-term limited representation in accordance with this Rule, a lawyer undertakes to represent the client in the matter on an ongoing basis, Rules 1.7, 1.9(a), and 1.10 become applicable.

INFORMATION ABOUT LEGAL SERVICES

Rule 7.1 Communications Concerning a Lawyer's Services

A lawyer shall not make a false or misleading communication about the lawyer or the lawyer's services. A communication is false or misleading if it contains a material misrepresentation of fact or law, or omits a fact necessary to make the statement considered as a whole not materially misleading.

Comment:

[1] This Rule governs all communications about a lawyer's services, including advertising permitted by Rule 7.2. Whatever means are used to make known a lawyer's services, statements about them must be truthful.

[2] Truthful statements that are misleading are also prohibited by this Rule. A truthful statement is misleading if it omits a fact necessary to make the lawyer's communication considered as a whole not materially misleading. A truthful statement is also misleading if there is a substantial likelihood that it will lead a reasonable person to formulate a specific conclusion about the lawyer or the lawyer's services for which there is no reasonable factual foundation.

[3] An advertisement that truthfully reports a lawyer's achievements on behalf of clients or former clients may be misleading if presented so as to lead a reasonable person to form an unjustified expectation that the same results could be obtained for other clients in similar matters without reference to the specific factual and legal circumstances of each client's case. Similarly, an unsubstantiated comparison of the lawyer's services or fees with the services or fees of other lawyers may be misleading if presented with such specificity as would lead a reasonable person to conclude that the comparison can be substantiated. The inclusion of an appropriate disclaimer or qualifying language may preclude a finding that a statement is likely to create unjustified expectations or otherwise mislead the public.

[4] See also Rule 8.4(e) for the prohibition against stating or implying an ability to influence improperly a government agency or official or to achieve results by means that violate the Rules of Professional Conduct or other law.

Rule 7.2 Advertising

(a) Subject to the requirements of Rule 7.1, a lawyer may advertise services through written, recorded or electronic communications, including public media, not within the purview of Rule 7.3.

(b) A copy or recording of an advertisement or written communication shall be kept for two years after its last dissemination along with a record of when and where it was used. This record shall include the name of at least one lawyer responsible for its content.

(c) A lawyer shall not give anything of value to a person for recommending the lawyer's services, except that a lawyer may pay:

(1) the reasonable cost of advertisements or written communications permitted by this Rule;

(2) the usual charges of a lawyer referral service or other legal service organization; and,

(3) for a law practice in accordance with Rule 1.17.

(d) No advertisement or public communication shall contain an endorsement by a celebrity or public figure.

(e) An advertisement or public communication that contains a paid endorsement shall disclose that the endorser is being paid or otherwise compensated for his or her appearance or endorsement.

(f) A non-lawyer shall not portray a lawyer or imply that he or she is a lawyer in any advertisement or public communication; nor shall an advertisement or public communication portray a fictitious entity as a law firm, use a fictitious name to refer to lawyers not associated together in a law firm, or otherwise imply that lawyers are associated together in a law firm if that is not the case.

(g) An advertisement or public communication shall not contain a portrayal of a client by a non-client; the re-enactment of any events or scenes; or, pictures or persons, which are not actual or authentic, without a disclosure that such depiction is a dramatization.

(h) Every advertisement that contains information about the lawyer's fee shall be subject to the following requirements:

(1) Advertisements that state or indicate that no fee shall be charged in the absence of recovery shall disclose that the client will be liable for certain expenses in addition to the fee, if such is the case; and,

(2) A lawyer who advertises a specific fee or hourly rate or range of fees for a particular service shall honor the advertised fee for at least ninety (90) days; provided that for advertisements in media published annually, the advertised fee shall be honored for no less than one (1) year following initial publication unless otherwise stated as part of the advertisement.

(i) All advertisements and written communications shall disclose the geographic location, by city or town, of the office in which the lawyer or lawyers who will actually perform the services advertised principally practice law. If the office location is outside the city or town, the county in which the office is located must be disclosed.

(j) A lawyer shall not, directly or indirectly (whether through an advertising cooperative or otherwise), pay all or any part of the costs of an advertisement by a lawyer not in the same firm or by any for-profit entity other than the lawyer's firm, unless the advertisement discloses the name and principal office address of each lawyer or law firm involved in paying for the advertisement and, if any lawyer or law firm will receive referrals from the advertisement, the circumstances under which referrals will be made and the basis and criteria on which the referral system operates.

(k) A lawyer shall not, directly or indirectly, advertise that the lawyer or his or her law firm will only accept, or has a practice limited to, particular types of cases unless the lawyer or his or her law firm handles, as a principal part of his, her or its practice, all aspects of the cases so advertised from intake through trial. If a lawyer or law firm advertises for a particular type of case that the lawyer or law firm ordinarily does not handle from intake through trial, that fact must be disclosed. A lawyer or law firm shall not advertise as a pretext to refer cases obtained from advertising to other lawyers.

Comment:

[1] To assist the public in learning about and obtaining legal services, lawyers should be allowed to make known their services not only through reputation but also through organized information campaigns in the form of advertising. Advertising involves an active quest for clients, contrary to the tradition that a lawyer should not seek clientele. However, the public's need to know about legal services can be fulfilled in part through advertising. This need is particularly acute in the case of persons of moderate means who have

not made extensive use of legal services. The interest in expanding public information about legal services ought to prevail over considerations of tradition. Nevertheless, advertising by lawyers entails the risk of practices that are misleading or overreaching.

[2] This Rule permits public dissemination of information concerning a lawyer's name or firm name, address, email address, website, and telephone number; the kinds of services the lawyer will undertake; the basis on which the lawyer's fees are determined, including prices for specific services and payment and credit arrangements; a lawyer's foreign language ability; names of references and, with their consent, names of clients regularly represented; and other information that might invite the attention of those seeking legal assistance.

[3] Questions of effectiveness and taste in advertising are matters of speculation and subjective judgment. Some jurisdictions have had extensive prohibitions against television and other forms of advertising, against advertising going beyond specified facts about a lawyer, or against "undignified" advertising. Television, the Internet, and other forms of electronic communication are now among the most powerful media for getting information to the public, particularly persons of low and moderate income; prohibiting television, Internet, and other forms of electronic advertising, therefore, would impede the flow of information about legal services to many sectors of the public. Limiting the information that may be advertised has a similar effect and assumes that the bar can accurately forecast the kind of information that the public would regard as relevant. But see Rule 7.3(a) for the prohibition against a solicitation through a real-time electronic exchange initiated by the lawyer.

[4] Neither this Rule nor Rule 7.3 prohibits communications authorized by law, such as a notice to members of a class in class action litigation.

Record of Advertising

[5] Paragraph (b) requires that a record of the content and use of advertising be kept in order to facilitate enforcement of this Rule. It does not require that advertising be subject to review prior to dissemination. Such a requirement would be burdensome and expensive relative to its possible benefits, and may be of doubtful constitutionality.

Paying Others to Recommend a Lawyer

[6] Subject to the limitations set forth under paragraphs (c) and (j), a lawyer is allowed to pay for advertising permitted by this Rule, but otherwise is not permitted to pay another person for recommending the lawyer's services or for channeling professional work in a manner that violates Rule 7.3. A communication contains a recommendation if it endorses or vouches for a lawyer's credentials, abilities, competence, character, or other professional qualities. Paragraph (c)(1), however, allows a lawyer to pay for advertising and communications permitted by this Rule, including the cost of print, directory listings, online directory listings, newspaper ads, television and radio air time, domain name registrations, sponsorship fees, Internet-based advertisements, and group advertising. A lawyer may compensate employees, agents and vendors who are engaged to provide marketing or client-development services, such as publicists, public relations personnel, business development staff and website designers. Moreover, a lawyer may pay others for generating client leads, such as Internet-based client leads, as long as the lead generator does not recommend the lawyer, any payment to the lead generator is consistent with Rules 1.5(e) and 5.4, and the lead generator's communications are consistent with Rule 7.1. To comply with Rule 7.1, a lawyer must not pay a lead generator that states, implies, or creates a reasonable impression that it is recommending the lawyer, is making the referral without payment from the lawyer, or has analyzed a person's legal problems when determining which lawyer should receive the referral. See also Rule 5.3 for the duties of lawyers and law firms with respect to the conduct of non-lawyers and Rule 8.4(a). This restriction does not prevent an organization or person other than the lawyer from advertising or recommending the lawyer's services. Thus, a legal aid agency or prepaid legal services plan may pay to advertise legal services provided under its auspices. Likewise, a lawyer may participate in lawyer referral programs and pay the usual fees charged by such programs. Paragraph (c) does not prohibit paying regular compensation to an assistant, such as a secretary, to prepare communications permitted by this Rule.

Endorsements

[7] Paragraphs (d) and (e) require truthfulness in any advertising in which an endorsement of a lawyer or law firm is made. The prohibition against endorsement by a celebrity or public figure is consistent

with the purpose of Rule 7.1 to avoid the creation of an unjustified expectation of a particular legal result on the part of a prospective client.

Portrayals

[8] Paragraphs (f) and (g), similarly, require truth in advertising when portrayals are made part of legal advertising. A portrayal, by its nature, is a depiction of a person, event or scene, not the actual person, event or scene itself. Paragraphs (f) and (g) were added to ensure that any portrayals used in advertising legal services are not misleading or overreaching. Creating the impression that lawyers are associated in a firm where that is not the case was considered inherently misleading because it suggests that the various lawyers involved are available to support each other and contribute to the handling of a case. Paragraph (f) accordingly prohibits advertisements that create the impression of a relationship among lawyers where none exists, such as by using a fictitious name to refer to the lawyers involved if they are not associated together in a firm.

Disclosure of Fees and Client Expenses

[9] Consistent with the public's need to have an accurate dissemination of information about the cost of legal services, paragraph (h) requires disclosure of a client's responsibility for payment of expenses in contingent fee matters when the client will be required to pay any portion of expenses that will be incurred in the handling of a legal matter.

[10] Under the same rationale, paragraph (h) imposes minimum periods of time during which advertised fees must be honored.

Disclosure of Geographic Location of Practice

[11] Paragraph (i) requires disclosure of the geographic location in which the advertising lawyer's primary practice is situated. This provision seeks to rectify situations in which a person seeking legal services is misled into concluding that an advertising lawyer has his or her primary practice in the client's hometown when, in fact, the advertising lawyer's primary practice is located elsewhere. Paragraph (i) ensures that a client has received a disclosure as to whether the lawyer he or she ultimately chooses maintains a primary practice located outside of the client's own city, town or county.

Disclosure of Payment of Advertising Costs

[12] Paragraph (j) prohibits lawyers and law firms from paying advertising costs of independent lawyers or other persons unless disclosure is made in the advertising of the name and address of each paying lawyer or law firm, as well as of the business relationship between the paying parties and the advertising parties.

[13] Advertisements sponsored by advertising cooperatives (where lawyers or law firms pool resources to buy advertising space or time) are considered advertisements by each of the lawyers participating in the cooperative and accordingly will be subject generally to all of the provisions of these Rules on advertising. Advertising cooperatives have been referred to expressly in paragraph (j) to make clear that references to ''indirect'' actions are intended to have a wide scope and include advertising cooperatives and similar arrangements. Thus, advertising cooperatives and similar arrangements are permissible, but only if the required disclosures are made. In the case of cooperative arrangements, the required disclosures must include the basis or criteria on which lawyers or law firms participating in the cooperative will be referred cases, e.g., chronological order of calls, geographic location, etc.

[14] Paragraph (k) prohibits a lawyer from misleading the public by giving the impression in an advertisement that the lawyer or his or her law firm specializes in a particular area of the law unless the lawyer or his or her law firm handles the type of case advertised as a principal part of the practice of the lawyer or law firm. For example, where a lawyer advertises for ''personal injury cases'' or ''serious personal injury cases'' or ''death cases only'' those types of cases must, in fact, constitute a principal part of the practice of the lawyer or his or her firm.

[15] Paragraph (k) also prohibits advertising for the primary purposes of obtaining cases that can be referred or brokered to another lawyer. Obviously, a lawyer is permitted and encouraged to refer cases to other lawyers where that lawyer does not have the skill or expertise to properly represent a client. However,

it is misleading to the public for a lawyer or law firm, with knowledge that the lawyer or law firm will not be handling a majority of the cases attracted by advertising, to nonetheless advertise for those cases only to refer the cases to another lawyer whom the client did not initially contact. In addition, a lawyer who advertises for a particular type of case may not mislead the client into believing that the lawyer or law firm will fully represent that client when, in reality, the lawyer or law firm refers all of its non-settling cases to another law firm for trial.

Rule 7.3 Solicitation of Clients

(a) A lawyer shall not solicit in-person or by intermediary professional employment from a person with whom the lawyer has no family or prior professional relationship when a significant motive for the lawyer's doing so is the lawyer's pecuniary gain, unless the person contacted is a lawyer or has a family, close personal, or prior professional relationship with the lawyer. The term "solicit" includes contact in-person, by telephone or by real-time electronic communication, but, subject to the requirements of Rule 7.1 and Rule 7.3(b), does not include written communications, which may include targeted, direct mail advertisements.

(b) A lawyer may contact, or send a written communication to, the target of the solicitation for the purpose of obtaining professional employment unless:

(1) the lawyer knows or reasonably should know that the physical, emotional or mental state of the person is such that the person could not exercise reasonable judgment in employing a lawyer;

(2) the person has made known to the lawyer a desire not to receive communications from the lawyer;

(3) the communication involves coercion, duress, or harassment; or,

(4) the communication is a solicitation to a party who has been named as a defendant or respondent in a domestic relations action. In such cases, the lawyer shall wait until proof of service appears on the docket before communication with the named defendant or respondent.

Comment:

[1] A solicitation is a targeted communication initiated by the lawyer that is directed to a specific person and that offers to provide, or can reasonably be understood as offering to provide, legal services. In contrast, a lawyer's communication typically does not constitute a solicitation if it is directed to the general public, such as through a billboard, an Internet banner advertisement, a website or a television commercial, or if it is in response to a request for information or is automatically generated in response to Internet searches.

[2] There is a potential for abuse when a solicitation involves direct in-person, live telephone or real-time electronic contact by a lawyer with someone known to need legal services. These forms of contact subject a person to the private importuning of a trained advocate, in a direct interpersonal encounter. The person who may already feel overwhelmed by the circumstances giving rise to the need for legal services, may find it difficult fully to evaluate all available alternatives with reasoned judgment and appropriate self-interest in the face of the lawyer's presence and insistence upon being retained immediately. The situation is fraught with the possibility of undue influence, intimidation, and over-reaching.

[3] This potential for abuse inherent in direct in-person, live telephone or real-time electronic solicitation justifies its prohibition, particularly since lawyers have alternative means of conveying necessary information to those who may be in need of legal services. In particular, communications can be mailed or transmitted by email or other electronic means that do not involve real-time contact and do not violate other laws governing solicitations. These forms of communications and solicitations make it possible for the public to be informed about the need for legal services, and about the qualifications of available lawyers and law firms, without subjecting the public to direct in-person, telephone or real-time electronic persuasion that may overwhelm a person's judgment.

[4] The use of general advertising and written, recorded or electronic communications to transmit information from lawyer to the public, rather than direct in-person, live telephone or real-time electronic

contact, will help to assure that the information flows cleanly as well as freely. The contents of advertisements and communications permitted under Rule 7.2 can be permanently recorded so that they cannot be disputed and may be shared with others who know the lawyer. This potential for informal review is itself likely to help guard against statements and claims that might constitute false and misleading communications, in violation of Rule 7.1. The contents of direct in-person, live telephone or real-time electronic contact can be disputed and may not be subject to third-party scrutiny. Consequently, they are much more likely to approach (and occasionally cross) the dividing line between accurate representations from those that are false and misleading.

[5] There is far less likelihood that a lawyer would engage in abusive practices against a former client, or a person with whom the lawyer has a close personal or family relationship, or in situations in which the lawyer is motivated by considerations other than the lawyer's pecuniary gain. Nor is there a serious potential for abuse when the person contacted is a lawyer. Consequently, the general prohibition in Rule 7.3(a) is not applicable in those situations. Also, paragraph (a) is not intended to prohibit a lawyer from participating in constitutionally protected activities of public or charitable legal-service organizations or bona fide political, social, civic, fraternal, employee or trade organizations whose purposes include providing or recommending legal services to their members or beneficiaries.

[6] But even permitted forms of solicitation can be abused. Thus, any solicitation which contains information which is false or misleading within the meaning of Rule 7.1, which involves coercion, duress or harassment within the meaning of Rule 7.3(b)(3), or which involves contact with someone who has made known to the lawyer desire not to be solicited by the lawyer within the meaning of Rule 7.3(b)(2) is prohibited. Moreover, if after sending a letter or other communication as permitted by Rule 7.2 the lawyer receives no response, any further effort to communicate with the recipient of the communication may violate the provisions of Rule 7.3(b).

[7] This Rule is not intended to prohibit a lawyer from contacting representatives of organizations or groups that may be interested in establishing a group or prepaid legal plan for their members, insureds, beneficiaries or other third-parties for the purposes informing such entities of the availability of and details concerning the plan or arrangement which the lawyer or lawyer's firm is willing to offer. This form of communication is not directed to people who are seeking legal services for themselves. Rather, it is usually addressed to an individual acting in a fiduciary capacity seeking a supplier of legal services for others who may, if they choose, become prospective clients of the lawyer. Under these circumstances, the activity which the lawyer undertakes in communicating with such representatives and the type of information transmitted to the individual are functionally similar to and serve the same purpose as advertising permitted under Rule 7.2.

[8] In this instance, the term "domestic relations actions" includes the actions governed by the Family Court Rules, *see* Pa.R.C.P. No. 1931(a), and actions pursuant to the Protection of Victims of Sexual Violence or Intimidation Act, s*ee* 42 Pa.C.S. §§ 62A03 *et seq*. In such cases, a defendant/respondent party's receipt of a lawyer's solicitation prior to being served with the complaint can increase the risk of a violent confrontation between the parties. The prohibition in RPC 7.3(b)(4) against any solicitation prior to proof of service appearing on the docket is intended to reduce any such risk and allow for the plaintiff to take any appropriate steps.

Rule 7.4 Communication of Fields of Practice and Specialization

(a) A lawyer may communicate the fact that the lawyer does or does not practice in particular fields of law. A lawyer shall not state that the lawyer is a specialist except as follows:

(1) a lawyer admitted to engage in patent practice before the United States Patent and Trademark Office may use the designation "patent attorney" or a substantially similar designation;

(2) a lawyer engaged in admiralty practice may use the designation "admiralty," "proctor in admiralty," or a substantially similar designation;

(3) a lawyer who has been certified by an organization approved by the Supreme Court of Pennsylvania as a certifying organization in accordance with paragraph (b) may advertise the certification during such time as the certification of the lawyer and the approval of the organization are both in effect;

(4) a lawyer may communicate that the lawyer is certified in a field of practice only when that communication is not false or misleading and that certification is granted by the Supreme Court of Pennsylvania.

(b) Upon recommendation of the Pennsylvania Bar Association, the Supreme Court of Pennsylvania may approve for purposes of paragraph (a) an organization that certifies lawyers, if the Court finds that:

(1) advertising by a lawyer of certification by the certifying organization will provide meaningful information, which is not false, misleading or deceptive, for use of the public in selecting or retaining a lawyer; and

(2) certification by the organization is available to all lawyers who meet objective and consistently applied standards relevant to practice in the area of the law to which the certification relates.

The approval of the certifying organization shall be for such period not longer than five (5) years as the Court shall order, and may be renewed upon recommendation of the Pennsylvania Bar Association.

Comment:

[1] This Rule permits a lawyer to indicate areas of practice in communications about the lawyer's services; for example, in a telephone directory or other advertising. If a lawyer practices only in certain fields, or will not accept matters except in such fields, the lawyer is permitted so to indicate. However, stating that the lawyer is a ''specialist'' is not permitted unless the lawyer has been certified as a specialist by a certifying organization approved under the procedure of paragraph (b). The standards in paragraph (b)(1) and (2) are intended to comply with the requirements for advertising claims of specialization set forth in *Peel v. Attorney Registration and Disciplinary Commission of Illinois*, 496 U. S. 91, 110 L.Ed.2d 83, 110 S.Ct. 2281 (1990).

Rule 7.5 Firm Names and Letterheads

(a) A lawyer shall not use a firm name, letterhead or other professional designation that violates Rule 7.1. A trade name may be used by a lawyer in private practice if it does not imply a connection with a government, government agency or with a public or charitable legal services organization and is not otherwise in violation of Rule 7.1. If otherwise lawful a firm may use as, or continue to include in, its name, the name or names of one or more deceased or retired members of the firm or of a predecessor firm in a continuing line of succession.

(b) A law firm with offices in more than one jurisdiction may use the same name or other professional designation in each jurisdiction, but identification of the lawyers in an office of the firm shall indicate the jurisdictional limitations on those not licensed to practice in the jurisdiction where the office is located.

(c) The name of a lawyer holding a public office shall not be used in the name of a law firm, or in communications on its behalf, during any substantial period in which the lawyer is not actively and regularly practicing with the firm.

(d) Lawyers shall not state or imply that they practice in a partnership or other organization unless that is the fact.

Comment:

[1] A firm may be designated by the names of all or some of its members, by the names of deceased members where there has been a continuing succession in the firm's identity or by a trade name such as the ''ABC Legal Clinic.'' A lawyer or law firm may also be designated by a distinctive website address or comparable professional designation. Although the United States Supreme Court has held that legislation may prohibit the use of trade names in professional practice, use of such names in law practice is acceptable so long as it is not misleading. If a private firm uses a trade name that includes a geographical name such as ''Springfield Legal Clinic,'' an express disclaimer that it is a public legal aid agency may be required to avoid a

misleading implication. It may be observed that any firm name including the name of a deceased partner is, strictly speaking, a trade name. The use of such names to designate law firms has proven a useful means of identification. However, it is misleading to use the name of a lawyer not associated with the firm or a predecessor of the firm, or the name of a nonlawyer.

[2] With regard to paragraph (d), lawyers sharing office facilities, but who are not in fact associated with each other in a law firm, may not denominate themselves as, for example, ''Smith and Jones,'' for that title suggests that they are practicing law together in a firm.

Rule 7.6 [Reserved]

Rule 7.7 Lawyer Referral Service

(a) A lawyer shall not accept referrals from a lawyer referral service if the service engaged in communication with the public or direct contact with prospective clients in a manner that would violate the Rules of Professional Conduct if the communication or contact were made by the lawyer.

(b) A "lawyer referral service" is any person, group of persons, association, organization or entity that receives a fee or charge for referring or causing the direct or indirect referral of a potential client to a lawyer drawn from a specific group or panel of lawyers.

Comment:

[1] This Rule prevents a lawyer from circumventing the Rules of Professional Conduct by using a lawyer referral service or similar organization which would not be subject to the Rules of Professional Conduct. A lawyer may pay the usual charges of a lawyer referral service. A lawyer may not, however, share legal fees with a non-lawyer. See Rule 5.4(a).

MAINTAINING THE INTEGRITY OF THE PROFESSION

Rule 8.1 Bar Admission and Disciplinary Matters

An applicant for admission to the bar, or a lawyer in connection with a bar admission application or in connection with a disciplinary matter, shall not:

(a) knowingly make a false statement of material fact; or,

(b) fail to disclose a fact necessary to correct a misapprehension known by the person to have arisen in the matter, or knowingly fail to respond to a lawful demand for information from an admissions or disciplinary authority, except that this Rule does not require disclosure of information otherwise protected by Rule 1.6.

Comment:

[1] The duty imposed by this Rule extends to persons seeking admission to the bar as well as to lawyers. Hence, if a person makes a material false statement in connection with an application for admission, it may be the basis for subsequent disciplinary action if the person is admitted, and in any event may be relevant in a subsequent admission application. The duty imposed by this Rule applies to a lawyer's own admission or discipline as well as that of others. Thus, it is a separate professional offense for a lawyer to knowingly make a misrepresentation or omission in connection with a disciplinary investigation of the lawyer's own conduct. Paragraph (b) of this Rule also requires correction of any prior misstatement in the matter that the applicant or lawyer may have made and affirmative clarification of any misunderstanding on the part of the admissions or disciplinary authority of which the person involved becomes aware.

[2] This Rule is subject to the provisions of the fifth amendment of the United States Constitution and corresponding provisions of state constitutions. A person relying on such a provision in response to a

question, however, should do so openly and not use the right of nondisclosure as a justification for failure to comply with this Rule.

[3] A lawyer representing an applicant for admission to the bar, or representing a lawyer who is the subject of a disciplinary inquiry or proceeding, is governed by the rules applicable to the client-lawyer relationship, including Rule 1.6 and, in some cases, Rule 3.3.

Rule 8.2 Statements Concerning Judges and Other Adjudicatory Officers

(a) A lawyer shall not make a statement that the lawyer knows to be false or with reckless disregard as to its truth or falsity concerning the qualifications or integrity of a judge, adjudicatory officer or public legal officer, or of a candidate for election or appointment to judicial or legal office.

(b) A lawyer who is a candidate for judicial office shall comply with the applicable provisions of the Code of Judicial Conduct and/or the Rules Governing Standards of Conduct for Magisterial District Judges, as applicable.

Comment:

[1] Assessments by lawyers are relied on in evaluating the professional or personal fitness of persons being considered for election or appointment to judicial office and to public legal offices, such as attorney general, prosecuting attorney and public defender. Expressing honest and candid opinions on such matters contributes to improving the administration of justice. Conversely, false statements by a lawyer can unfairly undermine public confidence in the administration of justice.

[2] When a lawyer seeks judicial office, the lawyer should be bound by applicable limitations on political activity.

[3] To maintain the fair and independent administration of justice, lawyers are encouraged to continue traditional efforts to defend judges and courts unjustly criticized.

Rule 8.3 Reporting Professional Misconduct

(a) A lawyer who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects, shall inform the appropriate professional authority.

(b) A lawyer who knows that a judge has committed a violation of applicable rules of judicial conduct that raises a substantial question as to the judge's fitness for office shall inform the appropriate authority.

(c) This Rule does not require disclosure of information otherwise protected by Rule 1.6 or information gained by a lawyer or judge while participating in an approved lawyers assistance program.

Comment:

[1] Self-regulation of the legal profession requires that members of the profession initiate disciplinary investigation when they know of a violation of the Rules of Professional Conduct. Lawyers have a similar obligation with respect to judicial misconduct. An apparently isolated violation may indicate a pattern of misconduct that only a disciplinary investigation can uncover. Reporting a violation is especially important where the victim is unlikely to discover the offense.

[2] A report about misconduct is not required where it would involve violation of Rule 1.6. However, a lawyer should encourage a client to consent to disclosure where prosecution would not substantially prejudice the client's interests.

[3] If a lawyer were obligated to report every violation of the Rules, the failure to report any violation would itself be a professional offense. Such a requirement existed in many jurisdictions but proved

to be unenforceable. This Rule limits the reporting obligation to those offenses that a self-regulating profession must vigorously endeavor to prevent. A measure of judgment is, therefore, required in complying with the provisions of this Rule. The duty to report involves only misconduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer in other respects. The term "substantial" refers to the seriousness of the possible offense and not the quantum of evidence of which the lawyer is aware.

[4] While a lawyer may report professional misconduct at any time, the lawyer must report misconduct upon acquiring actual knowledge of misconduct. The discretionary reporting of misconduct should not be undertaken for purposes of tactical advantage over another lawyer, to punish or inconvenience another for a personal or professional slight, or to harass another lawyer.

[5] A report should be made to the bar disciplinary agency unless some other agency, such as a peer review agency, is more appropriate in the circumstances. Similar considerations apply to the reporting of judicial misconduct.

[6] The duty to report professional misconduct does not apply to a lawyer retained to represent a lawyer whose professional conduct is in question. Such a situation is governed by the Rules applicable to the client-lawyer relationship.

[7] Information about a lawyer's or judge's misconduct or fitness may be received by a lawyer in the course of that lawyer's participation in an approved lawyers or judges assistance program. In that circumstance, providing for an exception to the reporting requirements of paragraphs (a) and (b) of this Rule encourages lawyers and judges to seek treatment through such a program. Conversely, without such an exception, lawyers and judges may hesitate to seek assistance from these programs, which may then result in additional harm to their professional careers and additional injury to the welfare of clients and to the public. The Rules do not otherwise address the confidentiality of information received by a lawyer or judge participating in an approved lawyers assistance program; such an obligation, however, may be imposed by the rules of the program or other law.

[8] In addition to reporting a violation of another lawyer, a lawyer is required by the Pennsylvania Rules of Disciplinary Enforcement to self-report in certain circumstances. Pa.R.D.E. 214(a) provides that an attorney convicted of a crime shall report the fact of that conviction within 20 days to the Office of Disciplinary Counsel. For purposes of that rule, the term "crime" means an offense that is punishable by imprisonment in the jurisdiction of conviction, whether or not a sentence of imprisonment is actually imposed. It does not include parking violations or summary offenses, both traffic and non-traffic, unless a term of imprisonment is actually imposed.

[9] Likewise, Pa.R.D.E. 216(e) requires an attorney who has been transferred to disability inactive status or disciplined in another court or by any body authorized by law or by rule of court to conduct disciplinary proceedings against attorneys by any state or territory of the United States or of the District of Columbia, a United States court, or by a federal administrative agency or a military tribunal, by suspension, disbarment, or revocation of license or pro hac vice admission, or who has resigned from the bar or otherwise relinquished his or her license to practice while under disciplinary investigation in another jurisdiction, to report the fact of that transfer, suspension, disbarment, revocation or resignation to the Disciplinary Board of the Supreme Court of Pennsylvania within 20 days after the date of the order, judgment or directive imposing or confirming the discipline or transfer to disability inactive status.

Rule 8.4 Misconduct

It is professional misconduct for a lawyer to:

(a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;

(b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;

(c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

(d) engage in conduct that is prejudicial to the administration of justice;

(e) state or imply an ability to influence improperly a government agency or official or to achieve results by means that violate the Rules of Professional Conduct or other law;

(f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law; or

(g) in the practice of law, knowingly engage in conduct constituting harassment or discrimination based upon race, sex, gender identity or expression, religion, national origin, ethnicity, disability, age, sexual orientation, marital status, or socioeconomic status. This paragraph does not limit the ability of a lawyer to accept, decline or withdraw from a representation in accordance with Rule 1.16. This paragraph does not preclude advice or advocacy consistent with these Rules.

Comment:

[1] Lawyers are subject to discipline when they violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so or do so through the acts of another, as when they request or instruct an agent to do so on the lawyer's behalf. Paragraph (a), however, does not prohibit a lawyer from advising a client of action the client is lawfully entitled to take.

[2] Many kinds of illegal conduct reflect adversely on fitness to practice law, such as offenses involving fraud and the offense of willful failure to file an income tax return. However, some kinds of offenses carry no such implication. Traditionally, the distinction was drawn in terms of offenses involving "moral turpitude." That concept can be construed to include offenses concerning some matters of personal morality, such as adultery and comparable offenses that have no specific connection to fitness for the practice of law. Although a lawyer is personally answerable to the entire criminal law, a lawyer should be professionally answerable only for offenses that indicate lack of those characteristics relevant to law practice. Offenses involving violence, dishonesty, breach of trust, or serious interference with the administration of justice are in that category. A pattern of repeated offenses, even ones of minor significance when considered separately, can indicate indifference to legal obligation.

[3] For the purposes of paragraph (g), conduct in the practice of law includes (i) interacting with witnesses, coworkers, court personnel, lawyers, or others, while appearing in proceedings before a tribunal or in connection with the representation of a client; (ii) operating or managing a law firm or law practice; or (iii) participation in judicial boards, conferences, or committees; continuing legal education seminars; bench bar conferences; and bar association activities where legal education credits are offered. The term "the practice of law" does not include speeches, communications, debates, presentations, or publications given or published outside the contexts described in (i)-(iii).

[4] "Harassment" means conduct that is intended to intimidate, denigrate or show hostility or aversion toward a person on any of the bases listed in paragraph (g). "Harassment" includes sexual harassment, which includes but is not limited to sexual advances, requests for sexual favors, and other conduct of a sexual nature that is unwelcome.

[5] "Discrimination" means conduct that a lawyer knows manifests an intention: to treat a person as inferior based on one or more of the characteristics listed in paragraph (g); to disregard relevant considerations of individual characteristics or merit because of one or more of the listed characteristics; or to cause or attempt to cause interference with the fair administration of justice based on one or more of the listed characteristics.

[6] A lawyer may refuse to comply with an obligation imposed by law upon a good faith belief that no valid obligation exists. The provisions of Rule 1.2(d) concerning a good faith challenge to the validity, scope, meaning or application of the law apply to challenges of legal regulation of the practice of law.

[7] Lawyers holding public office assume legal responsibilities going beyond those of other citizens. A lawyer's abuse of public office can suggest an inability to fulfill the professional role of lawyers. The same is true of abuse of positions of private trust such as trustee, executor, administrator, guardian, agent and officer, director or manager of a corporation or other organization.

Rule 8.5 Disciplinary Authority; Choice of Law

(a) *Disciplinary Authority*. A lawyer admitted to practice in this jurisdiction is subject to the disciplinary authority of this jurisdiction, regardless of where the lawyer's conduct occurs. A lawyer not admitted in this jurisdiction is also subject to the disciplinary authority of this jurisdiction if the lawyer provides or offers to provide any legal services in this jurisdiction. A lawyer may be subject to the disciplinary authority of both this jurisdiction and another jurisdiction for the same conduct.

(b) *Choice of Law*. In any exercise of the disciplinary authority of this jurisdiction, the rules of professional conduct to be applied shall be as follows:

(1) for conduct in connection with a matter pending before a tribunal, the rules of the jurisdiction in which the tribunal sits shall be applied, unless the rules of the tribunal provide otherwise; and,

(2) for any other conduct, the rules of the jurisdiction in which the lawyer's conduct occurred, or, if the predominant effect of the conduct is in a different jurisdiction, the rules of that jurisdiction shall be applied to the conduct. A lawyer shall not be subject to discipline if the lawyer's conduct conforms to the rules of a jurisdiction in which the lawyer reasonably believes the predominant effect of the lawyer's conduct will occur.

Comment:

Disciplinary Authority

[1] It is longstanding law that the conduct of a lawyer admitted to practice in this jurisdiction is subject to the disciplinary authority of this jurisdiction. Extension of the disciplinary authority of this jurisdiction to other lawyers who provide or offer to provide legal services in this jurisdiction is for the protection of the citizens of this jurisdiction. Reciprocal enforcement of a jurisdiction's disciplinary findings and sanctions will further advance the purposes of this Rule. See Pennsylvania Rules of Disciplinary Enforcement 201(a)(6) and 216(d). A lawyer who is subject to the disciplinary authority of this jurisdiction under Rule 8.5(a) appoints an official to be designated by this Court to receive service of process in this jurisdiction. The fact that the lawyer is subject to the disciplinary authority of this jurisdiction may be a factor in determining whether personal jurisdiction may be asserted over the lawyer for civil matters.

Choice of Law

[2] A lawyer may be potentially subject to more than one set of rules of professional conduct which impose different obligations. The lawyer may be licensed to practice in more than one jurisdiction with differing rules, or may be admitted to practice before a particular court with rules that differ from those of the jurisdiction or jurisdictions in which the lawyer is licensed to practice. Additionally, the lawyer's conduct may involve significant contacts with more than one jurisdiction.

[3] Paragraph (b) seeks to resolve such potential conflicts. Its premise is that minimizing conflicts between rules, as well as uncertainty about which rules are applicable, is in the best interest of both clients and the profession (as well as the bodies having authority to regulate the profession). Accordingly, it takes the approach of (i) providing that any particular conduct of a lawyer shall be subject to only one set of rules of professional conduct, (ii) making the determination of which set of rules applies to particular conduct as straightforward as possible, consistent with recognition of appropriate regulatory interests of relevant jurisdictions, and (iii) providing protection from discipline for lawyers who act reasonably in the face of uncertainty.

[4] Paragraph (b)(1) provides that as to a lawyer's conduct relating to a proceeding pending before a tribunal, the lawyer shall be subject only to the rules of the jurisdiction in which the tribunal sits unless the rules of the tribunal, including its choice of law rule, provide otherwise. As to all other conduct, including conduct in anticipation of a proceeding not yet pending before a tribunal, paragraph (b)(2) provides that a lawyer shall be subject to the rules of the jurisdiction in which the lawyer's conduct occurred, or, if the predominant effect of the conduct is in another jurisdiction, the rules of that jurisdiction shall be applied to the conduct. In the case of conduct in anticipation of a proceeding that is likely to be before a tribunal, the

predominant effect of such conduct could be where the conduct occurred, where the tribunal sits or in another jurisdiction.

[5] When a lawyer's conduct involves significant contacts with more than one jurisdiction, it may not be clear whether the predominant effect of the lawyer's conduct will occur in a jurisdiction other than the one in which the conduct occurred. So long as the lawyer's conduct conforms to the rules of a jurisdiction in which the lawyer reasonably believes the predominant effect will occur, the lawyer shall not be subject to discipline under this Rule.

[6] If two admitting jurisdictions were to proceed against a lawyer for the same conduct, they should, applying this Rule, identify the same governing ethics rules. They should take all appropriate steps to see that they do apply the same rule to the same conduct, and in all events should avoid proceeding against a lawyer on the basis of two inconsistent rules.

[7] The choice of law provision applies to lawyers engaged in transnational practice, unless international law, treaties or other agreements between competent regulatory authorities in the affected jurisdictions provide otherwise**.**

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TAB 2

D'Aliessi, Michele: "How Does the Blockchain Work?" *Medium OneZero*, June 1, 2016
https://medium.com/one-zero/how-does-the-blockchain-work-98c8cd01d2ae [Illustrations]

How Does the Blockchain Work?

Blockchain technology explained in simple words

Michele D'Aliessi

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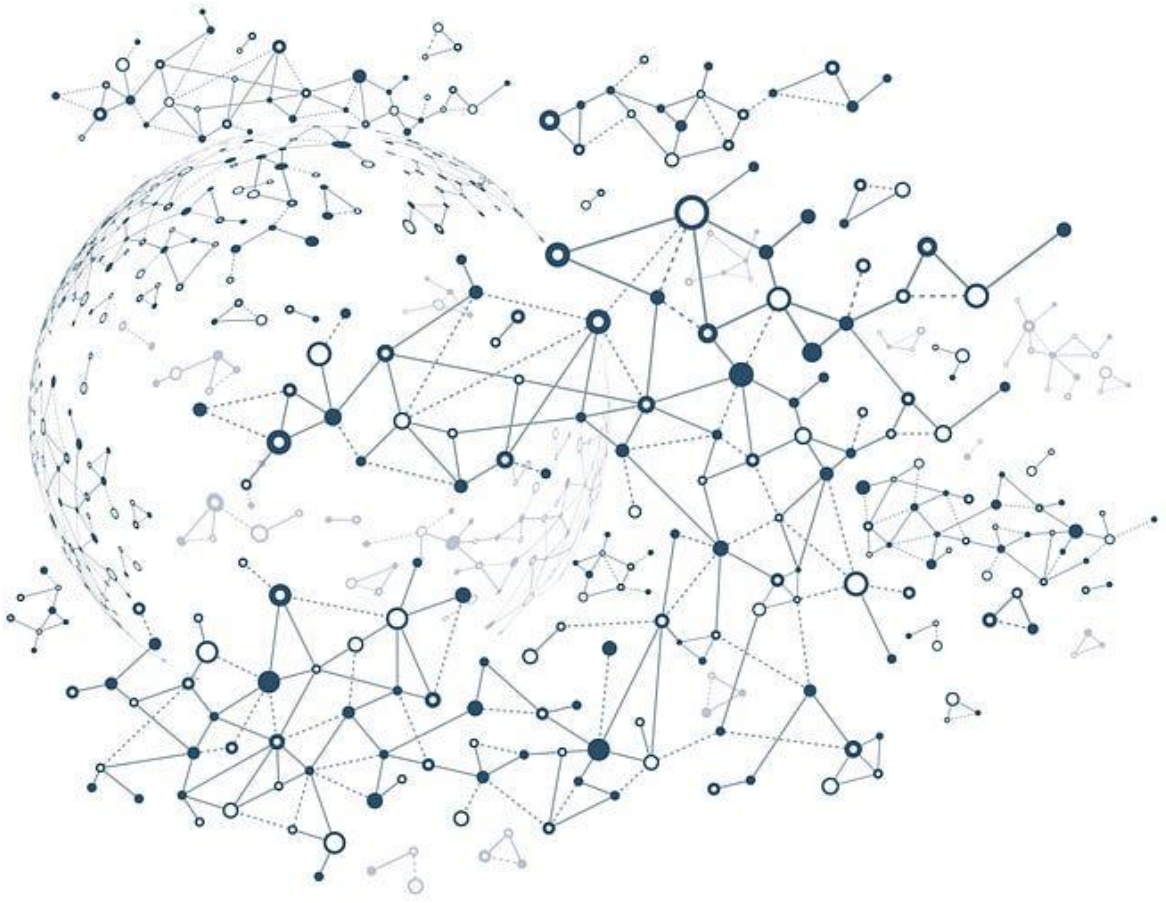
Jun 1, 2016



Credit: Ani_Ka/DigitalVision Vectors/Getty

Blockchain technology is probably the best invention since the internet itself. It allows value exchange without the need for trust or a central authority. Imagine you and I bet $50 on tomorrow's weather in San Francisco. I bet it will be sunny, you that it will rain. Today we have three options to manage this transaction:

1. We can *trust* each other. Rainy or sunny, the loser will give $50 to the winner. If we are friends, this could be a good way of managing it. However, friends or strangers, one can easily not pay the other.

2. We can turn the bet into a *contract*. With a contract in place both parties will be more prone to pay. However, should either of the two decide not to pay, the winner will have to pay additional money to cover legal expenses and the court case might take a long time. Especially for a small amount of cash, this doesn't seem like the optimal way to manage the transaction.

3. We can involve a *neutral third party*. Each of us gives $50 to a third party, who will give the total amount to the winner. But hey, she could also run away with all our money. So we end up with one of the first two options: *trust* or *contract*.

Neither trust nor contract is an optimal solution: We can't trust strangers, and enforcing a contract requires time and money. The blockchain technology is interesting because it offers us a third option which is secure, quick, and cheap.

Blockchain allows us to write a few lines of code, a program running on the blockchain, to which both of us send $50. This program will keep the $100 safe and check tomorrow's weather automatically on several data sources. Sunny or rainy, it will automatically transfer the whole amount to the winner. Each party can check the contract logic, and once it's running on the blockchain it can't be changed or stopped. This may be too much effort for a $50 bet, but imagine selling a house or a company.

This article explains how the blockchain works without discussing the technical details in depth, but by digging just enough to give you a general idea of the underlying logic and mechanisms.

Also available in Simplified Chinese and Mandarin thanks to volunteering efforts and blockchain community support.

The Basics of Bitcoin

Images courtesy of author.

The most known and discussed application of the blockchain technology is bitcoin, a digital currency that can be used to exchange products and services, just like the U.S. dollar, euro, Chinese yuan, and other national currencies. Let's use this first application of the blockchain technology to learn how it works.

"Bitcoin gives us, for the first time, a way for one Internet user to transfer a unique piece of digital property to another Internet user, such that the transfer is guaranteed to be safe and secure, everyone knows that the transfer has taken place, and nobody can challenge the legitimacy of the transfer. The consequences of this breakthrough are hard to overstate."

— Marc Andreessen

One bitcoin is a single unit of the Bitcoin (BTC) digital currency. Just like a dollar, a bitcoin has no value by itself; it has value only because we agree to trade goods and services to bring more of the currency under our control, and we believe others will do the same.

To keep track of the amount of bitcoin each of us owns, the blockchain uses a ledger, a digital file that tracks all bitcoin transactions.

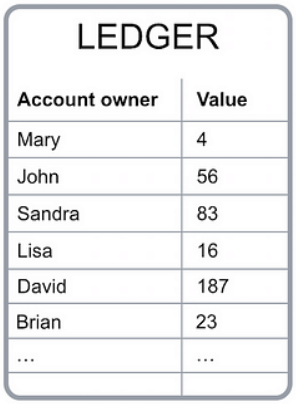


Fig. 1 - Bitcoin ledger digital file simplified

The ledger file is not stored in a central entity server, like a bank, or in a single data center. It is distributed across the world via a network of private computers that are both storing data and executing computations. Each of these computers represents a "node" of the blockchain network and has a copy of the ledger file.

If David wants to send bitcoins to Sandra, he broadcasts a message to the network that says the amount of bitcoin in his account should go down by 5 BTC, and the amount in Sandra's account should increase by the same quantity. Each node in the network will receive the message and apply the requested transaction to its copy of the ledger, updating the account balances.

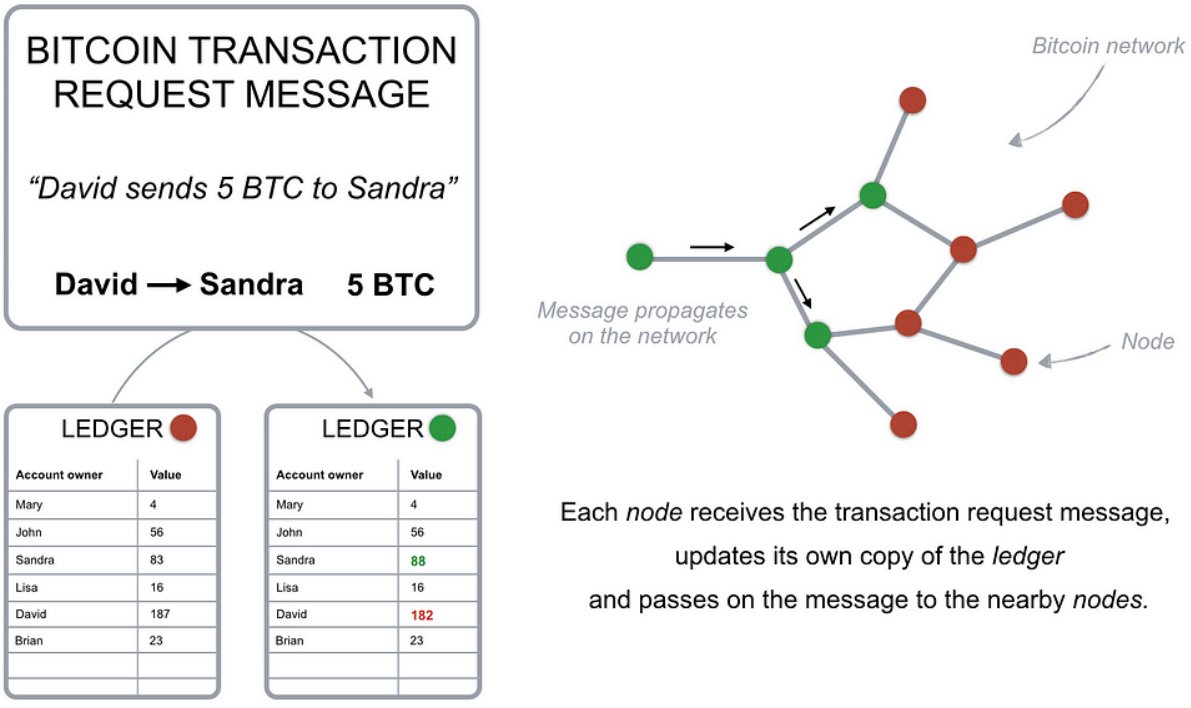


Fig. 2 - Transaction request message simplified

The fact that the ledger is maintained by a group of connected computers rather than by a centralized entity like a bank has several implications:

- In our bank system we only know our own transactions and account balances; on the blockchain everyone can see everyone else's transactions.
- While you can generally trust your bank, the bitcoin network is distributed and if something goes wrong there is no help desk to call or anyone to sue.
- The blockchain system is designed in such a way that no trust is needed; security and reliability are obtained via special mathematical functions and code.

We can define the blockchain as a system that allows a group of connected computers to maintain a single updated and secure ledger. In order to perform transactions on the blockchain, you need a wallet, a program that allows you to store and exchange your bitcoins. Since only you should be able to spend your bitcoins, each wallet is protected by a special cryptographic method that uses a unique pair of distinct but connected keys: a private and a public key.

If a message is encrypted with a specific public key, only the owner of the paired private key can decrypt and read the message. The reverse is also true: If you encrypt a message with your private key, only the paired public key can decrypt it. When David wants to send bitcoins, he needs to broadcast a message encrypted with the private key of his wallet. As David is the only one who knows the private key necessary to unlock his wallet, he is the only one who can spend his bitcoins. Each node in the network can cross-check that the transaction request is coming from David by decrypting the message with the public key of his wallet.

When you encrypt a transaction request with your wallet's private key, you are generating a digital signature that is used by blockchain computers to verify the source and authenticity of the transaction. The digital signature is a string of text resulting from your transaction request and your private key; therefore it cannot be used for other transactions. If you change a single character in the transaction request message, the digital signature will change, so no potential attacker can change your transaction requests or alter the amount of bitcoin you are sending.

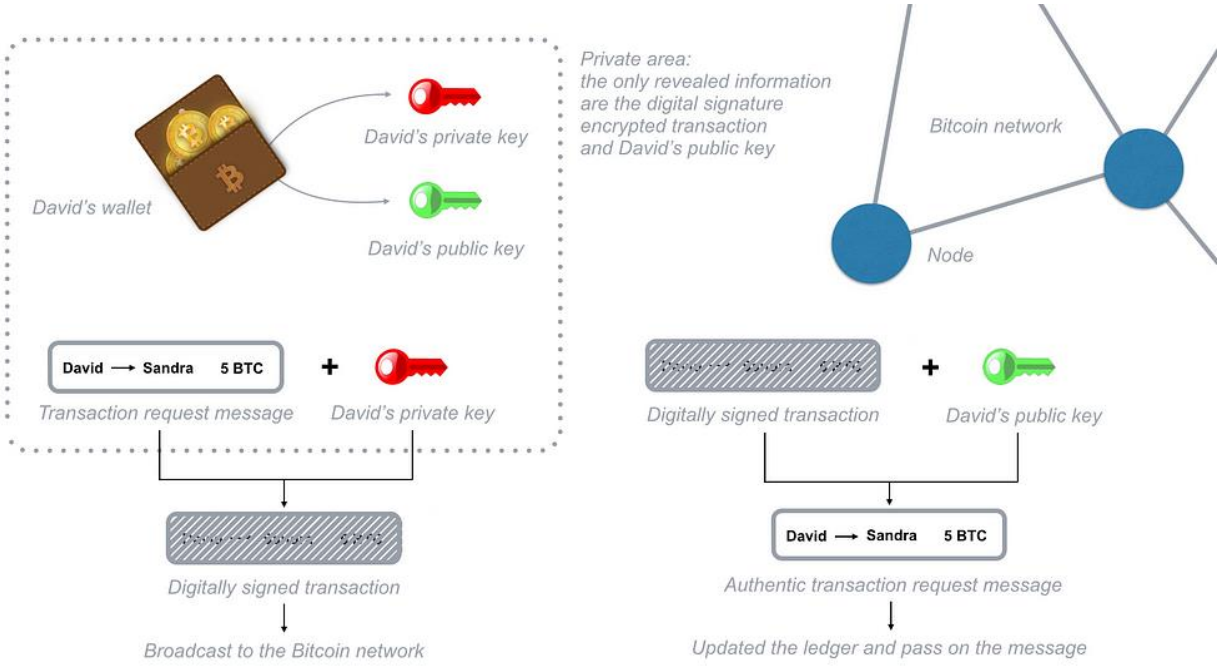


Fig. 3 - Digital Signature transaction encryption simplified

To send bitcoin you need to prove that you own the private key of a specific wallet as you need the key to encrypt your transaction request message. Since you broadcast the message only after it has been encrypted, you never have to reveal your private key.

Tracking Your Wallet Balance

Each node in the blockchain is keeping a copy of the ledger. So, how does a node know your account balance? The blockchain system doesn't keep track of account balances at all; it only records each and every transaction that is verified and approved. The ledger in fact does not keep track of balances, it only keeps track of every transaction broadcasted within the bitcoin network (Fig. 4). To determine your wallet balance, you need to analyze and verify all the transactions that ever took place on the whole network connected to your wallet.

LEDGER

Transactions	Value
Mary → John	10.000
John → Lisa	0.345
Sandra → David	18.4332
Lisa → Sandra	7.156
David → Mary	12.3402
Brian → Lisa	3.029381
...	...

Fig. 4 - Blockchain Ledger

This “balance” verification is performed based on links to previous transactions. In order to send 10 bitcoins to John, Mary has to generate a transaction request that includes links to previous incoming transactions that add up to at least 10 bitcoins. These links are called “inputs.” Nodes in the network verify the amount and ensure that these inputs haven’t been spent yet. In fact, each time you reference inputs in a transaction, they are deemed invalid for any future transaction. This is all performed automatically in Mary’s wallet and double-checked by the bitcoin network nodes; she only sends a 10 BTC transaction to John’s wallet using his public key.

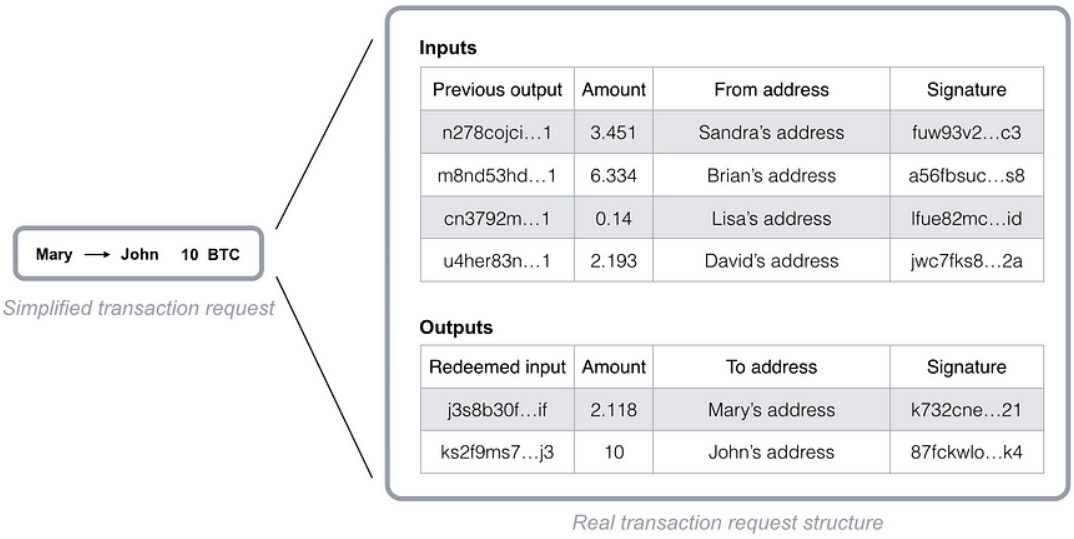


Fig. 5 - Blockchain transaction request structure

So, how can the system trust that input transactions are valid? It checks all the previous transactions correlated to the wallet you use to send bitcoins via the input references. To speed up the verification process, a special record of unspent transactions is kept by the network nodes. Thanks to this security check, it is not possible to double-spend bitcoins.

Owning bitcoins means that there are transactions written in the ledger that point to your wallet address and haven’t been used as inputs yet. All the code to perform transactions on the bitcoin network is open source; this means that anyone with a laptop and an internet connection can operate transactions. However, should there be a mistake in the code used to broadcast a transaction request message, the associated bitcoins will be permanently lost.

Remember that since the network is distributed, there is no customer support to call nor anyone who could help you restore a lost transaction or forgotten wallet password. For this reason, if you are interested in transacting on the bitcoin network, it’s a good idea to use the open source and official version of bitcoin wallet software (such as Bitcoin Core), and to store your wallet’s password or private key in a very safe repository.

But Is It Really Safe? And Why Is It Called Blockchain?

Anyone can access the bitcoin network via an anonymous connection (for example, the TOR network or a VPN network), and submit or receive transactions revealing nothing more than his public key. However if someone uses the same public key over and over, it’s possible to connect all the transactions to the same owner. The bitcoin network allows you to generate as many wallets as you like, each with its own private

and public keys. This allows you to receive payments on different wallets, and there is no way for anyone to know that you own all these wallets' private keys, unless you send all the received bitcoins to a single wallet.

The total number of possible bitcoin addresses is 2^{160} or 1461501637330902918203684832716283019655932542976.

This large number protects the network from possible attacks while allowing anyone to own a wallet.

With this setup, there is still a major security hole that could be exploited to recall bitcoins after spending them. Transactions are passed from node to node within the network, so the order in which two transactions reach each node can be different. An attacker could send a transaction, wait for the counterpart to ship a product, and then send a reverse transaction back to his own account. In this case, some nodes could receive the second transaction before the first and therefore consider the initial payment transaction invalid, as the transaction inputs would be marked as already spent. How do you know which transaction has been requested first? It's not secure to order the transactions by timestamp because it could easily be counterfeit. Therefore, there is no way to tell if a transaction happened before another, and this opens up the potential for fraud.

If this happens, there will be disagreement among the network nodes regarding the order of transactions each of them received. So the blockchain system has been designed to use node agreement to order transactions and prevent the fraud described above.

The bitcoin network orders transactions by grouping them into blocks; each block contains a definite number of transactions and a link to the previous block. This is what puts one block after the other in time. Blocks are therefore organized into a time-related chain (Fig. 6) that gives the name to the whole system: *blockchain*.

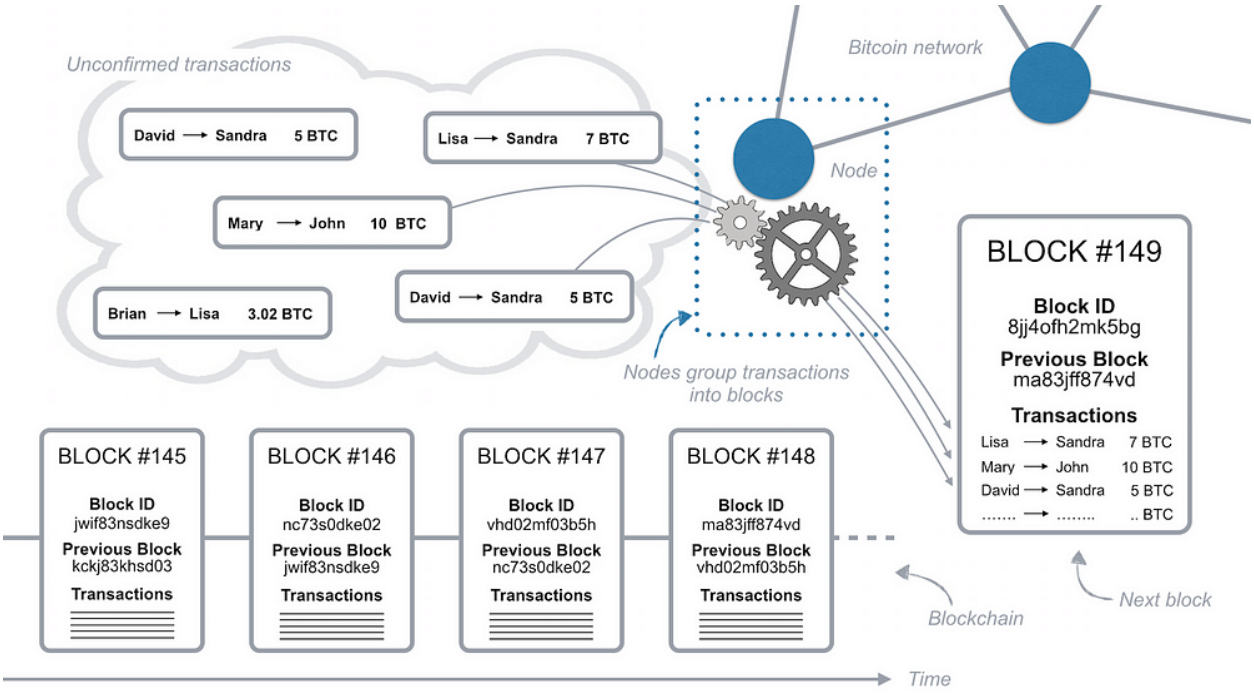


Fig. 6 — The block chain sequence structure simplified

Transactions in the same block are considered to have happened at the same time, and transactions not yet in a block are considered unconfirmed. Each node can group transactions into a block and broadcast it to the network as a suggestion for which block should be next. Since any node can suggest a new block, how does the system agree on which block should be the next?

To be added to the blockchain, each block must contain the answer to a complex mathematical problem created using an irreversible cryptographic hash function. The only way to solve such a mathematical problem is to guess random numbers that, combined with the previous block content, generate a defined result. It could take about a year for a typical computer to guess the right number and solve the mathematical problem. However, due to the large number of computers in the network that are guessing numbers, a block is solved on average every 10 minutes. The node that solves the mathematical problem acquires the right to place the next block on the chain and broadcast it to the network.

And what if two nodes solve the problem at the same time and send their blocks to the network simultaneously? In this case, both blocks are broadcast and each node builds on the block that it received first. However, the blockchain system requires each node to build immediately on the longest blockchain available. So if there is ambiguity about which is the last block, as soon as the next block is solved, each node will adopt the longest chain as the only option.

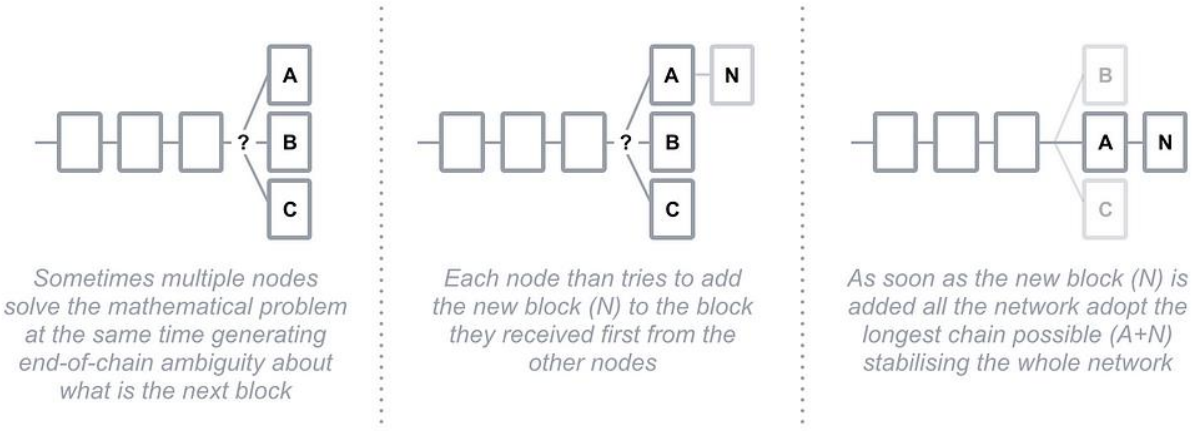


Fig.7 - End of chain ambiguity logic

Due to the low probability of solving blocks simultaneously, it's almost impossible that multiple blocks would be solved at the same time over and over, building different "tails," so the whole blockchain stabilizes quickly to one single string of blocks that every node agrees on.

A disagreement about which block represents the end of the chain tail opens up the potential for fraud again. If a transaction happens to be in a block that belongs to a shorter tail (like block B in Fig. 7), once the next block is solved, this transaction, along with all others in its block, will go back to the unconfirmed transactions.

Transactions in the Bitcoin blockchain system are protected by a mathematical race: Any attacker is competing against the whole network.

Let's see how Mary could leverage this end-of-chain ambiguity to perform a double-spending attack. Mary sends money to John, John ships the product to Mary. Since nodes always adopt the longer tail as

the confirmed transactions, if Mary could generate a longer tail that contains a reverse transaction with the same input references, John would be out of both his money and his product.

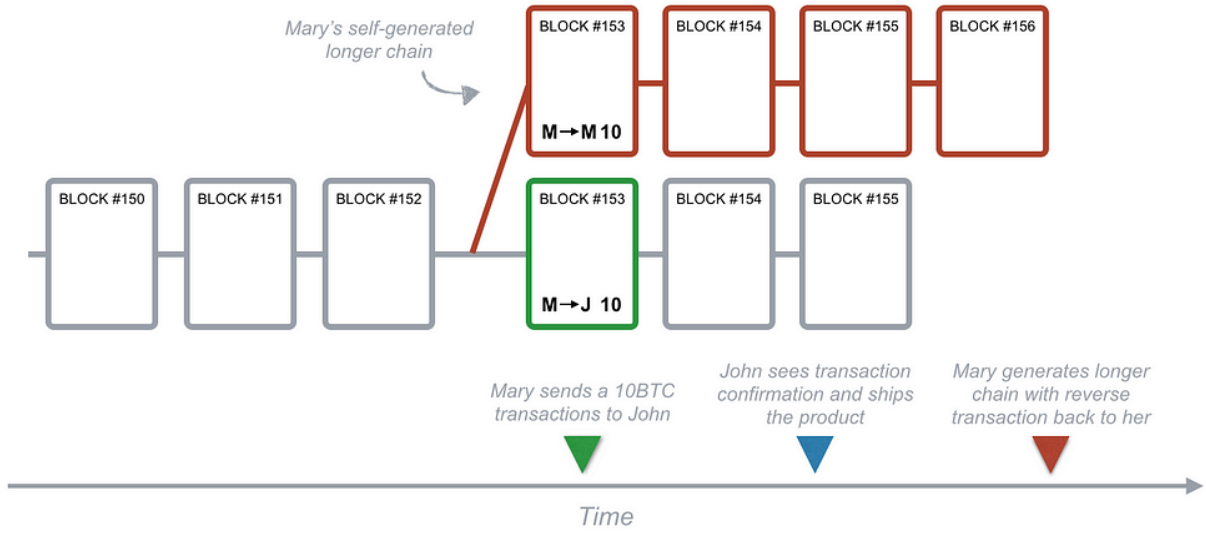


Fig. 8 - Mary's double-spending attack

How does the system prevent this kind of fraud? Each block contains a reference to the previous block (see Fig. 6). That reference is part of the mathematical problem that needs to be solved in order to spread the following block to the network. So, it's extremely hard to pre-compute a series of blocks due to the high number of random guesses needed to solve a block and place it on the blockchain. Mary is in a race against the rest of the network to solve the math problem that allows her to place the next block on the chain. Even if she solves it before anyone else, it's very unlikely she could solve two, three, or more blocks in a row, since each time she is competing against the whole network.

Could Mary use a super fast computer to generate enough random guesses to compete with the whole network in solving blocks? Yes, but even with a very, very fast computer, due to the large number of members in the network, it's highly unlikely Mary could solve several blocks in a row at the exact time needed to perform a double-spending attack.

She would need control of 50 percent of the computing power of the whole network to have a 50 percent chance of solving a block before some other node does — and even in this case, she'd only have a 25 percent chance of solving two blocks in a row. The more blocks to be solves in a row, the lower the probability of her success. Transactions in the bitcoin blockchain system are protected by a mathematical race: Any attacker is competing against the entire network.

Therefore, transactions grow more secure with time. Those included in a block confirmed one hour ago, for example, are more secure than those in a block confirmed in the last 10 minutes. Since a block is added to the chain every 10 minutes on average, a transaction included in a block for the first time an hour ago has most likely been processed and is now irreversible.

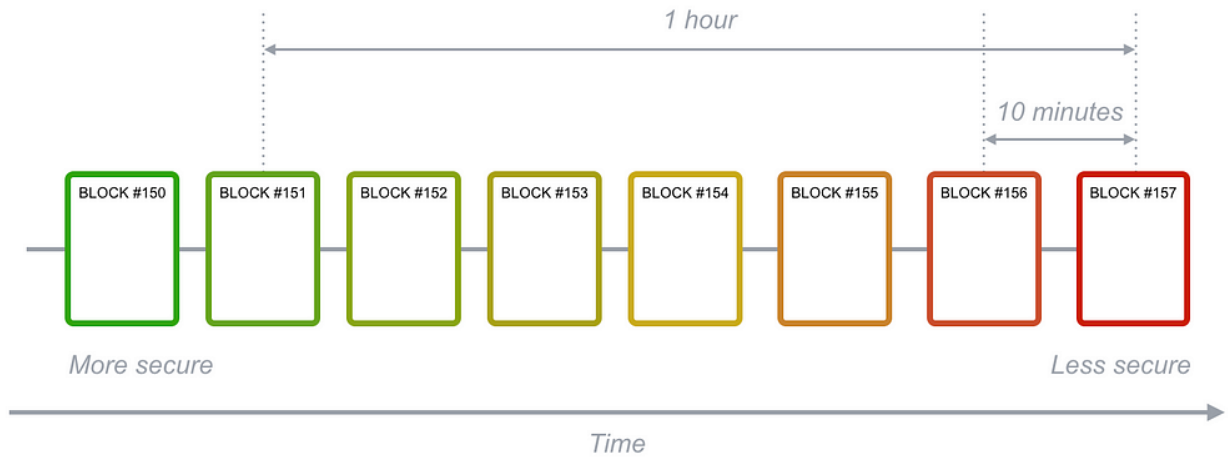


Fig. 9 - Blockchain transactions security

Mining Bitcoin

In order to send bitcoins, you need to reference an incoming transaction to your own wallet. This applies to every single transaction across the network. So, where do bitcoins come from in the first place?

As a way to balance the deflationary nature of bitcoin due to software errors and wallet password loss, a reward is given to those who solve the mathematical problem of each block. The activity of running the bitcoin blockchain software in order to obtain these bitcoin rewards is called “mining” — and it’s very much like mining gold.

Rewards are the main incentive for private people to operate the nodes, thus providing the necessary computing power to process transactions and stabilize the blockchain network.

Because it takes a long time for a typical computer to solve a block (about one year on average), nodes band together in groups that divide up the number of guesses to solve the next block. Working as a group speeds up the process of guessing the right number and getting the reward, which is then shared among group members. These groups are called mining pools.

Some of these mining pools are very large, and represent more than 20 percent of the total network computing power. This has clear implications for network security, as seen in the double-spend attack example above. Even if one of these pools could potentially gain 50 percent of the network computing power, the further back along the chain a block goes, the more secure the transactions within it become.

However, some of these mining pools with substantial computing power have decided to limit their members in order to safeguard overall network security.

Since the overall network computing power is likely to increase over time due to technological innovation and the increasing number of nodes, the blockchain system recalibrates the mathematical difficulty of solving the next block to target 10 minutes on average for the entire network. This ensures the network’s stability and overall security.

Moreover, every four years the block reward is cut in half, so mining bitcoin (running the network) gets less interesting over time. To encourage nodes to keep operating, small reward fees can be attached to each transaction; these rewards are collected by the node that successfully includes such transactions in a

block and solves its mathematical problem. Due to this mechanism, transactions associated with a higher reward are usually processed faster than those associated with a low reward. What this means is that, when sending a transaction, you can decide if you'd like to process it faster (more expensive) or cheaper (takes more time). Transaction fees in the bitcoin network are currently very small compared with what banks charge, and they're not associated with the transaction amount.

Blockchain Benefits and Challenges

Now that you have a general understanding of how the blockchain works, let's take a quick look at why it's so interesting.

Using blockchain technology has remarkable benefits:

- You have complete control of the value you own; there is no third party that holds your value or can limit your access to it.
- The cost to perform a value transaction from and to anywhere on the planet is very low. This allows micropayments.
- Value can be transferred in a few minutes, and the transaction can be considered secure after a few hours, rather than days or weeks.
- Anyone at any time can verify every transaction made on the blockchain, resulting in full transparency.
- It's possible to leverage the blockchain technology to build decentralized applications that would be able to manage information and transfer value fast and securely.

However, there are a few challenges that need to be addressed:

- Transactions can be sent and received anonymously. This preserves user privacy, but it also allows illegal activity on the network.
- Though many exchange platforms are emerging, and digital currencies are gaining popularity, it's still not easy to trade bitcoins for goods and services.
- Bitcoin, like many other cryptocurrencies, is very volatile: There aren't many bitcoins available in the market and the demand is changing rapidly. Bitcoin price is erratic, changing based on large events or announcements in the cryptocurrencies industry.

Overall, the blockchain technology has the potential to revolutionize several industries, from advertising to energy distribution. Its main power lies in its decentralized nature and ability to eliminate the need for trust.

New use cases are arising all the time — like the possibility of creating a fully decentralized platform that runs smart contracts like Ethereum. But it's important to remember that the technology is still in its infancy. New tools are being developed every day to improve blockchain security while offering a broader range of features, tools, and services.

Useful Links

- Get your own Bitcoin wallet
- Buy your first Bitcoins

- Start mining Bitcoin as a beginner or a pro
- Learn more about decentralized applications
- Make sure your Bitcoins are kept safe, away from hackers, with a Ledger Wallet

Blockchain

Bitcoin

Ethereum

ICO

Token

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TAB 3

Nebraska Ethics Advisory Opinion for Lawyers No. 17-03, 2017

NEBRASKA ETHICS ADVISORY OPINION FOR LAWYERS
NO. 17-03

I. Questions Presented

A. May an attorney receive digital currencies such as bitcoin as payment for legal services?
B. May an attorney receive digital currencies from third parties as payment for the benefit of a client's account?
C. May an attorney hold digital currencies in trust or escrow for clients?

II. Summary of Opinion

A. An attorney may receive and accept digital currencies such as bitcoin as payment for legal services. In order to assure that the fee charged remains reasonable under Neb. Ct. R. Prof. Cond. § 3-501.5(a), which prohibits charging unreasonable fees the attorney should mitigate the risk of volatility and possible unconscionable overpayment for services by (1) notifying the client that the attorney will not retain the digital currency units but instead will convert them into U.S. dollars immediately upon receipt; (2) converting the digital currencies into U.S. dollars at objective market rates immediately upon receipt through the use of a payment processor; and (3) crediting the client's account accordingly at the time of payment.

B. An attorney may receive digital currencies as payment from third-party payors so long as the payment prevents possible interference with the attorney's independent relationship with the client pursuant to Neb. Ct. R. of Prof. Cond. §3-501.7(a) or the client's confidential information pursuant to Neb. Ct. R. of Prof. Cond. §3-501.6 by implementing basic know-your-client ("KYC") procedures to identify any third-party payor prior to acceptance of payments made with digital currencies.

C. An attorney may hold bitcoins and other digital currencies in escrow or trust for clients or third parties pursuant to Neb. Ct. R. of Prof. Cond. §3-501.15(a) so long as the attorney holds the units of such currencies separate from the lawyer's property, kept with commercially reasonable safeguards and records are kept by the lawyer of the property so held for five (5) years after termination of the relationship. Because bitcoins are property rather than actual currency, bitcoins cannot be deposited into a client trust account created pursuant to Neb. Ct. R. §§ 3-901 to 3-907 (Trust Fund Requirements for Lawyers).

III. Statement of Facts

Bitcoin and similar computer program protocols are essentially shared ledger books maintained by networked computers. These protocols are often referred to as "digital currencies." Digital currency that has an equivalent value in real currency, or that acts as a substitute for real currency is referred to as "convertible" virtual currency. Bitcoin is one example of a convertible virtual currency. Bitcoins can be digitally traded between users and can be purchased for, or exchanged into, U.S. dollars, Euros and other real or virtual currencies. Notice 2014-21, 2014 I.R.B. 938 (4/14/14) entitled I.R.S. Virtual Currency Guidance.

Bitcoin exists on a decentralized peer-to-peer network on the Internet. It is "open source", which means that anyone with the requisite skill can obtain the computer program, review the programming code, evaluate it, use it or create their own version of the software. Bitcoins are stored in a computer file known as a "wallet". A person sending bitcoins to another person uses a "public key", a series of letters and numbers comprising the address to where the funds should be sent. The sender then utilizes a "private key", a code that authorizes the ledger book to make a change that debits the sender's wallet and credits the receiver's wallet.

Bitcoin has an advantage over traditional methods of transmitting value in that there are virtually no fees associated with transfer. Transfers are instant and the shared digital ledger book keeps track of all transactions while also preventing "counterfeiting".

Bitcoin and protocols using similar transactions are not anonymous. They have often been referred to as pseudonymous because it is possible, although difficult, to trace the identity of someone sending bitcoins on the network.

Bitcoin is used by both legitimate businesses and criminals. Legitimate businesses enjoy the ability to quickly receive "digital cash" that guarantees payment without the risk of chargebacks or credit card fees. Criminals, such as the ones that operated the website known as Silk Road, found that their operations were not entirely anonymous. Law enforcement agencies have been able shut down such sites while also arresting the operators and customers of the sites.

Bitcoin and other digital currencies are subject to extensive regulation in the United States. The U.S. Commodity Futures Trading Commission (CFTC), Department of the Treasury and the IRS consider Bitcoin to be property and subject to capital gains taxes. FinCEN and the Department of the Treasury regulate Bitcoin exchangers and money transmitters through authority granted by the Bank Secrecy Act and other statutes. FinCEN requires money transmitters to be registered and implement know-your-client (KYC) and anti-money laundering (AML) procedures. In addition to the Federal

framework, each state regulates money transmitters. Some states, including the State of New York, recently adapted their money transmitter statutes to provide for this new technology, allowing for the receipt of digital currencies by merchants but requiring regulatory compliance for businesses selling to consumers. Nebraska's Money Transmitter Act at Neb. Rev. Stat. §8-2701, *et. seq.,* as passed in year 2013 arguably regulates money transmitters who use digital currencies. However, no Nebraska court or administrative body has yet publicly ruled as to whether a money transmission license is required to sell digital currencies and transmit them to buyers.

The price of bitcoins has been volatile. It is traded on dozens of various digital currency exchanges throughout the world. The price fluctuated from approximately $7.00 per bitcoin in January of 2013 to over $1,200.00 by December of 2013. Bitcoin sometimes fluctuates in value as much as ten percent (10%) per day. The price of a bitcoin has recently increased substantially. As of August 30, 2017, the price of a bitcoin was $4,627.77. The price of a bitcoin has been measured objectively using the market prices at various exchanges that sell bitcoins. One such organization, Coindesk, publishes a constant Bitcoin Price Index that considers the weighted average price of a bitcoin at exchanges that meet certain objective requirements such as minimum volume of trade. In year 2015, the New York Stock Exchange created the NYSE Bitcoin Index with the listing "NYXBT".

Presently there are a large number of Bitcoin payment processors including Coinbase (San Francisco), Bitpay (Atlanta) and Circle (New York). These services claim to eliminate the volatility risk by maintaining consistent exchange rates based on an objective value presented by various exchanges. Of the most established payment processors, Coinbase is licensed by the Nebraska Department of Banking and Finance as a money trasmitter under Nebraska's Money Transmitter Act.

A growing number of law firms in other jurisdictions accept bitcoins as payment for services, although it is unknown if they undertook any effort to determine whether such policy is allowed through their respective Bar Associations' Codes of Conduct.

IV. Applicable Rules of Professional Conduct

A. § 3-501.5(a), (b). Fees.

(a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses. The factors to be considered in determining the reasonableness of a fee include the following:

(1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

(2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;

(3) the fee customarily charged in the locality for similar legal services;

(4) the amount involved and the results obtained;

(5) the time limitations imposed by the client or by the circumstances;

(6) the nature and length of the professional relationship with the client;

(7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and

(8) whether the fee is fixed or contingent.

(b) The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client.

B. § 3-501.6. Confidentiality of information.

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to prevent the client from committing a crime or to prevent reasonably certain death or substantial bodily harm;

(2) to secure legal advice about the lawyer’s compliance with these Rules;

(3) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or

(4) to comply with other law or a court order.

(c) The relationship between a member of the Nebraska State Bar Association Committee on the Nebraska Lawyers Assistance Program or an employee of the Nebraska Lawyers Assistance

Program and a lawyer who seeks or receives assistance through that committee or that program shall be the same as that of lawyer and client for the purposes of the application of Rule 1.6.

C. § 3-501.7. Conflict of interest; current clients.

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

D. § 3-501.8. Conflict of interest; current clients; specific rules.

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted or required by these Rules.

(c) A lawyer shall not solicit any substantial gift from a client, including a testamentary gift, or prepare on behalf of a client an instrument giving the lawyer or a person related to the lawyer any substantial gift unless the lawyer or other recipient of the gift is related to the client. For purposes of this paragraph, related persons include a spouse, child, grandchild, parent, grandparent or other relative or individual with whom the lawyer or the client maintains a close, familial relationship.

(d) Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation.

(e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:

(1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and

(2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

(1) the client gives informed consent;

(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

(3) information relating to representation of a client is protected as required by Rule 1.6.

(g) A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregated agreement as to guilty or nolo contendere pleas, unless each client gives informed consent, in a writing signed by the client. The lawyer's disclosure shall include the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.

(h) A lawyer shall not:

(1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement; or

(2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith.

(i) A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

(1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and

(2) contract with a client for a reasonable contingent fee in a civil case.

(j) A lawyer shall not have sexual relations with a client unless a consensual sexual relationship existed between them when the client-lawyer relationship commenced.

(k) While lawyers are associated in a firm, a prohibition in the foregoing paragraphs (a) through (i) that applies to any one of them shall apply to all of them.

E. § 3-501.15. Safekeeping property.

(a) A lawyer shall hold property of clients or third persons that is in a lawyer's possession in connection with a representation separate from the lawyer's own property. Funds shall be kept in a separate account maintained in the state where the lawyer's office is situated. Other property shall be identified as such and appropriately safeguarded. Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of 5 years after termination of the representation.

(b) A lawyer may deposit the lawyer's own funds in a client trust account for the sole purpose of paying bank service charges on that account, but only in an amount necessary for that purpose.

(c) A lawyer shall deposit into a client trust account legal fees and expenses that have been paid in advance, to be withdrawn by the lawyer only as fees are earned or expenses incurred.

(d) Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. Except as stated in this rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such property.

(e) When in the course of representation a lawyer is in possession of property in which two or more persons (one of whom may be the lawyer) claim interests, the property shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the property as to which the interests are not in dispute.

V. Discussion

A. Receiving Payments in Digital Currencies as Payment for Services.

Comment 4 of the Neb. Ct. R. Prof. Cond. § 3-501 expressly allows accepting property in payment of services. Therefore, there is no per se rule prohibiting payment of earned legal fees with convertible virtual currency since it is a form of property. However, Nebraska attorneys must be careful to see that this property they accept as payment is not contraband, does not reveal client secrets, and is not used in a money-laundering or tax avoidance scheme; because convertible virtual currencies can be associated with such mischief.

According to Neb. Ct. R. of Prof. Cond. §3-501.5(a), there is a prohibition on unreasonable fees. The values of bitcoins and other digital currencies often fluctuate dramatically. An arrangement for payment in bitcoin for attorney services could mean that the client pays $200.00 an hour in one month and $500.00 an hour the next month, which the client could very easily allege as unconscionable. Conversely, if the market value of the digital currency used as payment quickly fell, the attorney would be underpaid for services.

To mitigate or eliminate the risk of volatility, it is possible to value or convert bitcoins and other digital currencies into U.S. dollars immediately upon receipt. The conversion rate would be market based such as from an exchange or based upon the New York Stock Exchange Price Index, for example. In this way, the bitcoins would serve to credit the client's account and there would be no risk to the client of value fluctuation. As part of this process, a law office would need to disclose to the client that the firm would not be retaining the bitcoins but converting them to cash upon receipt. Through this method, the client is informed that an increase in the value of their bitcoins will not additionally fund their outstanding account. In addition, clients need not be concerned if the value of the bitcoins they sent for payment suddenly dropped.

Such a process should include (1) notifying the client that the attorney will not retain the digital currency units but instead will convert them into U.S. dollars immediately upon receipt; (2) converting the digital currencies into U.S. dollars at objective market rates immediately upon receipt through the use of a payment processor; and (3) crediting the client's account accordingly at the time of payment. Providing the client the notifications described in this opinion can best be accomplished by including the appropriate notifications in the fee agreement between lawyers and client. Under this framework, the client is properly informed, the use of bitcoins as payment would not result in

unconscionable fees to the attorney and the receipt of bitcoins as payment to the attorney would conform to the Nebraska Code of Professional Conduct.

B. Receiving Payments in Digital Currencies from Third-Party Payers.

Any time a client arranges for a third party to pay the client's attorney fees the attorney must keep in mind his or her obligations under the Nebraska Code of Professional Conduct. The Code allows an attorney to accept payment from a third party only if the arrangement would not interfere with the attorney's independence or relationship with the client (Neb. Ct. R. of Prof. Cond. §§3-501.7(a), 3-501.8(f)) nor interfere with the client's confidential information (Neb. Ct. R. of Prof. Cond. §3-501.6).

The dilemma faced by an attorney in identifying a third-party payer is that the use of bitcoins is pseudonymous and often close to anonymous. An attorney should comply with the requirements by use of standard Know Your Client ("KYC") procedures when receiving payments from third parties. Most Bitcoin payment processing services require the disclosure of the user's identity. Bitcoin payment processors including Coinbase (San Francisco), Bitpay (Atlanta) and Circle (New York) require the payer to complete a KYC form in order to use their service for payment. In any other situation, the attorney should request sufficient KYC information from the third-party payer prior to acceptance of the digital currency payment.

C. Receiving and Holding Digital Currencies in Trust or in Escrow.

It is permissible to hold bitcoins and other digital currencies in escrow or trust for clients or third parties pursuant to Neb. Ct. R. of Prof. Cond. §3-501.15(a). This Rule allows attorneys to store property as well as currency on behalf of a client. The property must be held separate from the lawyer's property, be properly safeguarded and records must be kept by the lawyer of account funds or other property for five (5) years after termination of representation. Bitcoins are treated as property for federal tax purposes.

Due to the volatility in the value of bitcoins and other digital currencies, the client and parties should be advised that the property held in trust or escrow will be held and not converted into U.S. dollars or other currency. Records of that notice and the records of the separate wallet used to store the bitcoins would be maintained by the lawyer. The shared nature of the blockchain allows anyone, including the client or regulators, to verify the amount of bitcoins and any transactions regarding the separate wallet maintained by the attorney.

Due to security concerns, an attorney opting to receive client payments in Bitcoin or storing them on behalf of clients, whether in trust or in escrow, must take reasonable security precautions. There is no bank or FDIC insurance to reimburse a Bitcoin holder if a hacker steals them. Once lost, bitcoins could be gone forever. Reasonable methods could include encryption of the private key required to send the bitcoins. Another method may include utilization of more than one private key (known as a "multi-signature account" or "multi-sig") for access to the bitcoins. Other reasonable measures may include maintenance of the wallet in a computer or other storage device that is disconnected from the Internet (also known as "cold storage"), a method that would also allow for off-line storage of one or more private keys.

However, unless converted to U.S. dollars, bitcoins cannot be deposited in a client trust account created pursuant to Neb. Ct. R. §§ 3-901 to 3-907 (Trust Fund Requirements for Lawyers). Thus, if a lawyer receives bitcoins intended to reflect a retainer to be drawn upon when fees are earned in the future, the lawyer must immediately convert the bitcoins into U.S. dollars in accord with section V(A) of this opinion.

Dated: September 11, 2017.

TAB 4

Washington, D.C. Bar: Ethics Opinion 378 - Acceptance of Cryptocurrency as Payment for Legal Fees. June 2020

Ethics Opinion 378

Acceptance of Cryptocurrency as Payment for Legal Fees

It is not unethical for a lawyer to accept cryptocurrency in lieu of more traditional forms of payment, so long as the fee is reasonable. A lawyer who accepts cryptocurrency as an advance fee on services yet to be rendered, however, must ensure that the fee arrangement is reasonable, objectively fair to the client, and has been agreed to only after the client has been informed in writing of its implications and given the opportunity to seek independent counsel. Additionally, a lawyer who takes possession of a client's cryptocurrency, either as an advance fee or in settlement of a client's claims, must also take competent and reasonable security precautions to safeguard that property.

Applicable Rules

- Rule 1.1 (Competence)
- Rule 1.5 (Fees)
- Rule 1.8 (Conflict of Interest: Specific Rules)
- Rule 1.15 (Safekeeping Property)

Background

Cryptocurrency is a virtual asset—digital money—that exists only in electronic form. It is completely decentralized, meaning there is no controlling authority, and it is not issued by any government or backed by any tangible security or real estate. Instead, cryptography (mathematical algorithms that are used to encode and decode information) controls the creation of new "coins" of a particular cryptocurrency and secures and records transactions. The resulting data is maintained in a virtual transaction ledger called a "blockchain," which is distributed to every computer on that cryptocurrency's network. The blockchain is a continually-expanding chronological record of transactions; it is comprised of "blocks" of information that include the source of cryptocurrency being transacted, its destination, and a date/time stamp. The most well-known cryptocurrencies are Bitcoin and Ethereum, but there are thousands of others.

Cryptocurrency, once acquired, may be spent like currency or held as an investment asset, like gold. Its algorithmic existence is "stored" in digital "wallets" maintained by online platforms ("hot wallets") or offline on a computer's hard drive, a USB port, or even paper ("cold wallets"). A cryptocurrency wallet also stores private and public keys, which are strings of alphanumeric characters that enable

their holder to receive or spend cryptocurrency. The public key is shared to allow others to send currency to a wallet. The private key allows its holder to access her wallet by writing in the public ledger, effectively spending the associated cryptocurrency.

The U.S. Internal Revenue Service (IRS) describes "virtual currency," *i.e.*, cryptocurrency, as "a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value."[1] Based on this definition, the IRS treats cryptocurrency as property rather than currency for U.S. federal tax purposes. And, despite having no physical existence and being "spendable" like money, cryptocurrency does seem similar to a commodity such as gold in that its exchange value is tied directly to market demand. But cryptocurrency as an asset is far more volatile than gold—one Bitcoin, for example, was worth $5,647.53 on September 19, 2017; $17,056.55 on December 11, 2017; $7,826.99 on February 5, 2018; $3,295.27 on December 10, 2018; and $10,241.35 on September 9, 2019.[2]

The nature of digital currency- as a new technology, a volatile alternative currency or asset, or client property- raises ethical challenges for lawyers that simply do not exist with fiat currency. But lawyers cannot hold back the tides of change even if they would like to, and cryptocurrency is increasingly accepted as a payment method by vendors and service providers, including lawyers.[3] Accordingly, the Committee provides this Opinion to assist lawyers who accept or even require payment of fees or settlement in cryptocurrency (or whose clients do) to meet their ethical obligations.

1. **Reasonableness of the Fee Arrangement**

Rule 1.5(a) states that "[a] lawyer's fee shall be reasonable." The rule includes a list of factors to be considered in determining the reasonableness of a fee, most of which concern the nature of the representation, the attorney's level of experience, and the client's needs and sophistication. Only two enumerated factors explicitly mention fees: whether the lawyer's fees are consistent with the customary rates charged in that locality for similar services,[4] and whether a fee is fixed or contingent.[5]

Rule 1.5(a) does not address terms of payment, and there is nothing in the "reasonableness" standard that prohibits lawyers from accepting potentially volatile assets as payment for fees; indeed, Comment 4 to Rule 1.5 states that "[a] lawyer may accept property . . . such as an ownership interest in an enterprise," as payment. Moreover, this Committee has previously acknowledged that a lawyer may accept an ownership interest in a client, including shares of corporate stock, as an *advance payment* on services to be rendered. *See* D.C. Bar Legal Ethics Opinion 300 (July 2000).[6]

Opinion 300 is particularly helpful in framing the reasonableness analysis applicable to digital currency. In that opinion, the Committee addressed the question of whether a lawyer could serve as part-time general counsel to a limited liability company in exchange for a 20% interest in the company and a share of future profits. We noted that "the pertinent question" was not "whether such a fee arrangement is ethical in principle; it clearly is. Rather, the question is whether a *particular*

ownership-in-lieu-of-fees arrangement is 'reasonable,' which calls for an analysis of reasonableness factors similar to that we have described in prior opinions." *Id.* (emphasis added). We emphasized that a lawyer's disclosures and explanation of the risk of paying advance fees in stock would be particularly relevant, as we "had no doubt that reasonableness would be measured, at least in part, by the extent to which the client's acceptance of the fee arrangement was informed by its understanding of [the] financial implications." *Id.*

We conclude that payment of fees in cryptocurrency is more akin to payment in property than payment in fiat currency. The financial implications of paying for a lawyer's services in a cryptocurrency will vary depending on the fee arrangement. A client who receives a bill for services rendered and elects to immediately transfer bitcoins to an attorney's wallet can be certain of the value of the payment, while a client who pays a lawyer an advance for services to be performed cannot predict the value of that cryptocurrency in a week, much less a month or a year. Therefore, the reasonableness of a fee agreement involving cryptocurrency will depend not only on the terms of the fee agreement itself and whether or not payment is for services rendered or in advance, but also on whether and how well the lawyer explains the nature of a client's particularized financial risks, in light of both the agreed fee structure and the inherent volatility of cryptocurrency.

2. **Acceptance of Cryptocurrency Under Rule 1.8(a)**

We agree with the conclusion of the New York City Bar Association's Committee on Professional and Judicial Ethics that an agreement to accept an advance retainer in cryptocurrency, or an agreement requiring a client to pay future earned fees in cryptocurrency, is subject to Rule of Professional Conduct 1.8(a) governing business transactions with clients.[7]

The D.C. rule, like the New York rule, reflects the fiduciary nature of the lawyer-client relationship.[8] It requires lawyers to ensure that all business dealings with clients are fundamentally fair, providing that:

> (a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client unless:
>
> (1) The transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client;
>
> (2) The client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and
>
> (3) The client consents in writing thereto.

Like the New York City Bar, we do not believe Rule 1.8(a) is implicated when a client opts to pay attorney's fees in cryptocurrency after receiving a bill, calculated in dollars, for fees already earned and costs incurred. An attorney may agree to accept the corresponding amount of cryptocurrency as a matter of client convenience without taking any special precautions beyond what is required by Rule 1.5 because this is a straightforward exchange involving no additional variables or special knowledge.

If, however, a lawyer and client agree that the client will provide cryptocurrency to be held by the lawyer as an advance fee against services to be performed, or if the lawyer's fees will be calculated in cryptocurrency (*e.g.*, the client agrees to pay one Bitcoin per month), then the lawyer and client are entering into a potentially adverse pecuniary relationship under Rule 1.8. This is because any such agreement necessarily involves considerable uncertainty about the future value of the cryptocurrency at the time the fee will be earned or, in the case of settlement, at the time the payments to third parties and the client will be made.

Rule 1.8(a), like Rule 1.5(a), requires a lawyer to adequately disclose the terms and implications of the fee arrangement, which must be reasonable. But Rule 1.8(a) goes significantly further: a lawyer who enters into a business relationship with a client must provide to the client written disclosure of the terms of the agreement and a reasonable opportunity to confer with independent counsel, and must obtain from the client written, informed consent to the agreement. Additionally, Rule 1.8(a) adds an independent ethical obligation to ensure that the fee arrangement is not only reasonable, but also "fair" to the client.

But at what point in the engagement is fairness to be determined? This question is particularly important when assessing the fairness of an agreement to accept and hold a volatile asset like cryptocurrency—or stocks, or future profits, or foreign currency—as advance fees for services not yet rendered. Once again, Opinion 300, concerning accepting stocks or partial ownership of a client in lieu of fees, is instructive:

> Rule 1.8(a) and the commentary thereto are silent on how fairness is to be determined, and whether it is to be determined only by reference to facts and circumstances existing at the time the arrangement is accepted by the parties, or by reference to subsequent developments (for example, a huge appreciation in the value of the shares received as fees such that the lawyer is effectively compensated at 100-fold the reasonable value of his services). For ethics purposes (and not for purposes of assessing common law fiduciary duties), we believe that the "fairness" of the fee arrangement should be judged at the time of the engagement. In other words, if the fee arrangement is "fair and reasonable to the client" at the time of the engagement, no ethical violation could occur if subsequent events, beyond the control of the lawyer, caused the fee to appear unfair or unreasonable.

Opinion 300 at fn 5; *see also* Restatement (Third) of the Law Governing Lawyers § 126, comment e (2000) ("Fairness is determined based on facts that reasonably could be known at the time of the

transaction, not as the facts later develop.")

Applying these principles, any fee arrangement that calculates fees in cryptocurrency, or that allows or requires a client to either provide an advance fee or accept a settlement payment from a third party in cryptocurrency, should be assessed for fairness at the time that it is agreed upon, based on the facts then available. For so long as the value of digital currency remains predictably volatile, this is a fact the lawyer must ensure that his or her client understands.

The information that must be disclosed to a particular client in writing under Rule 1.8(a) will, of course, vary. As a general matter, in addition to terms concerning billing rates and frequency, a lawyer accepting cryptocurrency should consider including a clear explanation of how the client will be billed (*i.e.* in dollars or cryptocurrency); whether and how frequently cryptocurrency held by the lawyer will be calculated in dollars, or otherwise trued-up or adjusted for accounting purposes and whether, upon that accounting, market increases and decreases in the value of the cryptocurrency triggers obligations by either party; whether the lawyer or the client will be responsible for cryptocurrency transfer fees (if any); which cryptocurrency exchange platform will be utilized to determine the value of cryptocurrency upon receipt and, in the case of advance fees, as the representation proceeds (*i.e.*, as fees are earned) and upon its termination; and who will be responsible if cryptocurrency accepted by the lawyer in settlement of the client's claims loses value and cannot satisfy third party liens.[9]

3. **Competently Safeguarding Cryptocurrency**

Rule 1.15(a) requires, among other things, that a lawyer "appropriately safeguard" the property of clients and third parties.[10] Paragraph (e) addresses advance fees, and provides that "advances of unearned fees and unincurred costs shall be treated as property of the client pursuant to paragraph (a) until earned or incurred unless the client gives informed consent to a different arrangement," and, that, even if the client does consent to a different arrangement,[11] any unearned or unincurred portion of an advance fee must be returned upon termination of the lawyer's services. See also Rule 1.16(d),[12] These rules, of course, apply to all advance fees, regardless of how they are funded. But, as with issues related to valuation, safeguarding cryptocurrency raises unique challenges.

The first rule of professional conduct is that lawyers must provide competent representation to their clients. See Rule 1.1. Although the Comments to Rule 1.1 do not specifically reference technology, we agree with ABA Comment [8] to Model Rule 1.1 that, to be competent, "a lawyer should keep abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology." Consistent with D.C. Bar Legal Ethics Opinion 371, which addressed lawyers' use of social media, a lawyer must have the skill required to exercise reasonable professional judgment regarding the use of technology, including digital currency, within the lawyer's legal practice.

In the case of cryptocurrency, competence requires lawyers to understand and safeguard against the many ways cryptocurrency can be stolen or lost. Because blockchain transactions are unregulated,

uninsured, anonymous, and irreversible, cryptocurrency is regularly targeted for digital fraud and theft. For example, cryptocurrency online wallets and exchange platforms may be fraudulent; legitimate wallets and platforms may be subject to security breaches; and private keys used to transfer cryptocurrency out of a person's wallet are vulnerable to network-based threats like hacking and malware if stored in a hot wallet (a device or system connected to the internet). Additionally, private keys that are stored in a cold wallet (hardware, offline software, or paper) can be irretrievably lost, in which case the associated digital currency is likely permanently inaccessible. Just as with fiat currency or any client property, a lawyer must use reasonable care to minimize the risk of loss.

Conclusion

We do not perceive any basis in the Rules of Professional Conduct for treating cryptocurrency as a uniquely unethical form of payment. Cryptocurrency is, ultimately, simply a relatively new means of transferring economic value, and the Rules are flexible enough to provide for the protection of clients' interests and property without rejecting advances in technologies. So long as the fee agreement between a lawyer and her client is objectively fair and reasonable (and otherwise complies with Rules 1.5 and 1.8), and the lawyer possesses the requisite knowledge to competently safeguard the client's digital currency, there is no prohibition against a lawyer accepting cryptocurrency from or on behalf of a client.

Published: June 2020

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1. I.R.S. Notice 2014-21, I.R.B. 2014-16 (Apr. 14, 2014).
2. Cryptocurrency's volatility is related to many factors, including the relatively limited adoption of digital currency, small market size, risk of security breaches, and lack of regulatory oversight and institutional investment. See https://www.blackwellglobal.com/why-are-cryptocurrencies-so-volatile/ (last visited November 12, 2019).
3. According to a November 2019 article, Quinn Emanuel Urquhart & Sullivan, Perkins Coie, Steptoe & Johnson LLP, Frost Brown Todd, and "a slew of smaller firms as well as solo practitioners have embraced the payment structure" of cryptocurrencies. Samantha Stokes, Quinn Emanuel Says Clients Can Pay In Bitcoin, available at https://www.law.com/americanlawyer/2019/11/05/quinn-emanuel-says-clients-can-pay-in-bitcoin/?slreturn=20200016135954.
4. Rule 1.5(a)(3).
5. Rule 1.5(a)(8).
6. Indeed, Bar Associations across the country have long agreed that a lawyer may accept fees in stock or equity interest in a client so long as the lawyer ensures that the client fully understands the financial implications and the terms are objectively fair to the client. See ABA Op. 00-418 (July 7, 2000), "Acquiring Ownership in a Client in Connection with Performing Legal Services"); N.Y.C. Eth. Op. 2000-3.
7. N.Y.C. Eth. Op. 2019-5.
8. "Because a lawyer occupies a multifaceted position of trust with regard to the client . . . there is an ever present fiduciary responsibility that arches over every aspect of the lawyer-client relationship, including fees. Connelly v. Swick & Shapiro, P.C., 749 A.2d 1264, 1268 (D.C. 2000) (internal citations omitted).
9. The lawyer bears the burden of proving that the transaction was fair and the client was adequately informed, and ambiguities will be construed in favor of the client. See, e.g. In re Martin, 67 A.3d 1032, 1041 (D.C. 2013) ("[A]ny ambiguity in

the [contingent fee] agreement would be interpreted against Martin, who drafted the agreement. See Capital City Mortg. Corp. v. Habana Vill. Art & Folklore, Inc., 747 A.2d 564, 567 (D.C. 2000) (stating that ambiguities in contracts will be 'construed strongly against the drafter.' ")); ABA Opinion 00-418.

10. Rule 1.15(a) also requires that lawyers maintain trust funds to hold money belonging to clients or third parties. Because cryptocurrency has been designated by the IRS as property rather than money, and because it cannot be deposited into a trust fund without being converted to money, this requirement is not applicable.

11. Any "different arrangement" must be fair to the client. "At a minimum, a lawyer must explain to the client 'the basis for this arrangement and . . . how [the client's] rights are protected by the arrangement.'" In re Mance, 980 A.2d 1196, 1207 (D.C. App. 2009), as amended (Oct. 29, 2009) (quoting In re Sather, 3 P.3d 403, 410 (Colo. 2000) (en banc)).

12. See also In re Mance, id. at 1202.

TAB 5

Virginia State Bar Legal Ethics Opinion 1898: Accepting Cryptocurrency as an Advance Fee for Legal Services. Sept. 17, 2022

VIRGINIA:

In the Supreme Court of Virginia held at the Supreme Court Building in the City of Richmond on Monday, the 19th day of September 2022.

On July 7, 2022, came the Virginia State Bar, by Stephanie E. Grana, its President, and Karen A. Gould, its Executive Director and Chief Operating Officer, pursuant to the Rules for Integration of the Virginia State Bar, Part Six, Section IV, Paragraph 10-4, and filed a Petition requesting consideration of Legal Ethics Opinion No. 1898.

Whereas it appears to the Court that the Virginia State Bar has complied with the procedural due process and notice requirements of the aforementioned Rule designed to ensure adequate review and protection of the public interest, upon due consideration of all material submitted to the Court, it is ordered that Legal Ethics Opinion No. 1898 be approved as follows, effective immediately:

LEGAL ETHICS OPINION 1898. ACCEPTING CRYPTOCURRENCY AS AN ADVANCE FEE FOR LEGAL SERVICES.

In this opinion the committee considers the ethics issues that arise when a lawyer accepts an advance fee paid by the client in Bitcoin or other cryptocurrency for legal services. For example, a lawyer is hired by a client to pursue a contested divorce against the client's spouse. The lawyer asks for an advance payment or fee of $20,000 to handle the case to completion with a final decree of divorce. The client wishes to pay the advance fee in Bitcoin. The client tenders the current market equivalent in Bitcoin to pay the advance fee of $20,000.

For purposes of this opinion, cryptocurrency also means virtual or digital currency.

QUESTIONS PRESENTED

1. **What are the ethical obligations of a lawyer who accepts cryptocurrency as an advance fee for payment for legal services?**
2. **May the lawyer keep the cryptocurrency in its digital form, or must it be converted to US Currency and deposited in the lawyer's trust account as required by Rule 1.15(a) of the Virginia Rules of Professional Conduct?**

3. **Is the lawyer's acceptance of cryptocurrency as an advance fee payment a "business transaction" subject to Rule 1.8(a) of the Virginia Rules of Professional Conduct?**

4. **What actions must the lawyer take to safekeep cryptocurrency that has been delivered to the lawyer as an advance fee?**

SHORT ANSWERS

1. A lawyer may accept cryptocurrency as an advance fee for services yet to be performed. However, the lawyer must ensure that the fee arrangement is reasonable, objectively fair to the client, and has been agreed to by the client only after being informed of its implications and given the opportunity to seek the advice of independent counsel, all of which is confirmed in writing. In addition, if the lawyer accepts cryptocurrency as an advance fee, the lawyer must also take competent and reasonable security precautions to safekeep the client's property.

2. Yes, the lawyer may keep the cryptocurrency in its digital form and is not required to convert payment into US currency and deposit the funds in the lawyer's trust account pursuant to Rule 1.15(a) of the Virginia Rules of Professional Conduct.

3. Yes, the lawyer's acceptance of cryptocurrency as an advance fee is a "business transaction" subject to Rule 1.8(a) of the Virginia Rules of Professional Conduct. However, Rule 1.8(a) does not apply if the lawyer accepts cryptocurrency as payment for an earned fee.

4. If cryptocurrency is used to pay an advance fee, the lawyer should safekeep cryptocurrency as client property with the care of a professional fiduciary and take reasonable security measures to safekeep the client's property from theft, loss, destruction or misdelivery.

APPLICABLE RULES OF PROFESSIONAL CONDUCT

> Rule 1.1: Competence. A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill,

thoroughness and preparation reasonably necessary for the representation.

* * *

Rule 1.5: Fees

(a) A lawyer's fee shall be reasonable.

(b) The lawyer's fee shall be adequately explained to the client.

* * *

Rule 1.8: Conflict of Interest; Special Rules

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client;

(2) the client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and

(3) the client consents in writing thereto.

* * *

Rule 1.15: Safekeeping Property

* * *

Comment [1]: A lawyer should hold property of others with the care required of a professional fiduciary. Securities should be kept in a safe deposit box, except when some other form of safekeeping is warranted by special circumstances. For purposes of this Rule, the term "fiduciary" includes personal representative, trustee, receiver, guardian, committee, custodian, and attorney-in-fact. All property that is the property of clients or third persons should be kept separate from the lawyer's business and personal property and, if funds, in one or more trust accounts.

Prior Relevant Virginia Legal Ethics Opinions

Legal Ethics Opinion 1593 (April 11, 1994); Virginia Legal Ethics Opinion 1489 (November 16, 1992); Virginia Legal Ethics Opinion 1041 (February 19, 1988); Virginia Legal Ethics Opinion 1564 (February 15, 1995).

DISCUSSION

Cryptocurrency is used as a medium of exchange via a peer-to-peer computer network that is not reliant on or controlled by any central authority such as a government or bank, to uphold, maintain or verify it. Cryptocurrency is given the name because it uses encryption to verify transactions. Advance coding is used in storing and transmitting cryptocurrency data between wallets and to public digital ledgers. Cryptocurrency is not currency in the traditional sense and while various names have been given to classify or categorize it (i.e., commodities, securities, as well as currencies), it is generally viewed as a distinct asset class. In 2014, the IRS issued Notice 2014-21, 2014-16 I.R.B. 938, explaining that cryptocurrency is taxed as property for Federal income tax purposes.

Cryptocurrency does not exist in physical form and is not issued by any central authority. It is a tradeable digital asset, or digital form of money, built on blockchain technology that exists only online. An advance payment by a client to a lawyer in cryptocurrency cannot be deposited into the lawyer's trust account. As of 2021 there were over ten thousand cryptocurrencies. Some popular currencies are Bitcoin, Ethereum, Litecoin and Dogecoin. Bitcoin, first released as open-source software in 2009, is the first decentralized cryptocurrency. Each cryptocurrency works through "distributed ledger technology," typically a blockchain, that serves as a public financial transaction database.

Holders or owners of cryptocurrency may use digital (hot) wallets or hardware (cold) wallets to store and secure cryptocurrency. Cryptocurrency may be purchased through an exchange using real currency and then stored in a wallet until the owner is ready to use it. Cryptocurrency may be used to send payments to individuals and businesses for goods and services, but it is not yet a form of payment that has mainstream acceptance. It is also held as a speculative and volatile investment that can increase or decrease rapidly in value. Because cryptocurrencies are driven by supply and demand, and have no central issuer or regulatory authority, they can fluctuate in value unpredictably from day to day or even minute to minute. Thus, an agreement to value a transaction in cryptocurrency or convert cryptocurrency into traditional currency on a certain date carries potential risks for both sides.

Considering a cryptocurrency's extreme fluctuation, any transaction in which it is used as an advance payment to a lawyer involves a great deal of risk undertaken by the lawyer and/or client as to the ultimate value of the legal services for which the parties have contracted. Unless an agreement between the lawyer and client is reached on when the value of the cryptocurrency payment is determined, the lawyer could, for example, receive an inappropriate windfall due to an extreme overpayment—an excessive and unreasonable fee for the value of the legal service. Because *all* fee agreements must be reasonable and adequately explained to the client, Rule 1.5(a) and (b) are applicable to lawyers who accept cryptocurrency as payment for legal fees.

Despite its market volatility, cryptocurrency as a medium of payment has rapidly made inroads to several marketplaces. As a result, some law firms are accepting or considering accepting certain cryptocurrencies, such as Bitcoin, as payment for legal services. *See*, e.g., Sara Merken, "More Law Firms are Accepting Bitcoin Payments," ABA BNA Lawyers Man. Prof. Conduct (Sept. 6, 2017); Melissa Stanzione, "Client Cryptocurrency Payments May Pose Ethical Risks for Lawyers," ABA BNA Lawyers Man. Prof. Conduct (May 11, 2019).

Given the extraordinary nature of the transaction, the committee agrees with three other state bar ethics opinions that the client's payment *of an advance fee* using cryptocurrency "has the essential qualities of a business transaction with the client" subject to the requirements of Rule 1.8(a). North Carolina State Bar Ethics Opinion 2019-05 (October 25, 2019); D.C. Bar Ethics Opinion 378 (June 2020); New York City Bar Ass'n Ethics Opinion 2019-5 (July 11, 2019).

As Rule 1.15 indicates, a lawyer is not limited to accepting money for payment of a legal fee and may instead accept property as payment for legal services. This committee has previously opined that a lawyer may accept property, for example stock in the client's company, as payment of the lawyer's advance fee on services to be rendered. Virginia Legal Ethics Opinion 1593 (April 11, 1994). Applying DR-5-104 of the Code of Professional Responsibility, the predecessor to Rule 1.8(a), the committee stated:

> An attorney may, under DR 5-104(A), provide legal services to a corporation in consideration of the stock issued so long as he feels his independent professional judgment will not be affected by his status as a stockholder, the

> client consents after full disclosure by the lawyer of the potential conflicts of interest, and provided that the transaction is not unconscionable, unfair or inequitable when made.

See also Comment [4], ABA Model Rule 1.5:

> A lawyer may accept property in payment for services, such as an ownership interest in an enterprise, providing this does not involve acquisition of a proprietary interest in the cause of action or subject matter of the litigation contrary to Rule 1.8(i). However, a fee paid in property instead of money may be subject to the requirements of Rule 1.8(a) because such fees often have the essential qualities of a business transaction with the client.

All three state bar ethics opinions cited above conclude that the lawyer's acceptance of cryptocurrency as payment of an advance fee is more in the nature of accepting *property* from the client rather than fiat currency. When a client is using cryptocurrency to pay an advance fee for future services, the reasonableness of the transaction is based not only on the amount of the fee charged by the lawyer for the legal service, but also on how well the lawyer has explained to the client the financial risks considering the agreed upon fee and the volatility of cryptocurrency.

Rule 1.8(a) recognizes the fiduciary relationship between attorney and client, requiring that a business transaction with the client must be fair and reasonable. The Rule requires that:

> (1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client;
>
> (2) the client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and
>
> (3) the client consents in writing thereto.

IS THE ACCEPTANCE OF CRYPTOCURRENCY AS AN ADVANCED LEGAL FEE A "BUSINESS TRANSACTION" UNDER RULE 1.8(a)?

In general, a "business transaction" between attorney and client is any business or commercial transaction other than the contract of representation. *See* Comment [1], ABA

Model Rule 1.8 ("does not apply to ordinary fee agreements between client and lawyer, which are governed by Rule 1.5, although its requirements must be met when the lawyer accepts an interest in the client's business or other nonmonetary property as payment of all or part of a fee.").

Also, as Comment [1] to Virginia Rule 1.8 explains:

> Paragraph (a) does not, however, apply to standard commercial transactions between the lawyer and the client for products or services that the client generally markets to others, for example, banking or brokerage services, medical services, products manufactured or distributed by the client, and utilities services. In such transactions, the lawyer has no advantage in dealing with the client, and the restrictions in paragraph (a) are unnecessary and impracticable.

For example, if a lawyer obtains a loan from a client while representing that client, that situation is subject to the "business transaction rule." Virginia Legal Ethics Opinion 1489 (November 16, 1992). *See also* Virginia Legal Ethics Opinion 1593, *supra* (attorney accepting stock in client's company for payment of legal fees); Virginia Legal Ethics Opinion 1041 (February 19, 1988) (attorney going into partnership with friend and drafting partnership agreement; assuming friend relied on attorney's services and professional judgment); Virginia Legal Ethics Opinion 1564 (February 15, 1995) (referral of real estate client to lawyer-owned company for title and settlement services). *See also* ABA Formal Opinion 00-418 (July 7, 2000) (acquiring ownership interest in client company, i.e., stock, while performing legal services for client company).

The transaction proposed in this opinion is not an ordinary fee agreement or a standard commercial transaction. Instead, as the New York City Bar Association's Ethics Committee observes:

> It is one in which the lawyer and the client must negotiate potentially complex questions, and in which an unsophisticated client may therefore place unwarranted trust in the lawyer to resolve these questions fairly or advantageously to the client. The variables associated with payment in cryptocurrency include the rate of exchange on any given day, any associated fees when converting cryptocurrency to currency, whether (and when) cryptocurrency must be converted into cash, the exchange to be used, the type of cryptocurrency being used (or whether the payment would be in a single cryptocurrency or a combination of cryptocurrencies), and how any dispute will

> be handled in the event of a disagreement between the lawyer and the client related to these issues.

AT WHAT POINT IN THE ENGAGEMENT IS "FAIRNESS" AND REASONABLENESS" TO BE DETERMINED?

This question is important when analyzing the fairness of a fee arrangement in which a volatile asset like cryptocurrency is being offered for services not yet rendered. In ABA Formal Opinion 00-418, *supra*, concerning accepting stocks or partial ownership of a client in lieu of fees the committee opined that:

> For purposes of judging the fairness and reasonableness of the transaction and its terms, the Committee's opinion is that, as when assessing the reasonableness of a contingent fee, only the circumstances reasonably ascertainable at the time of the transaction should be considered.

ABA Formal Op. 00-418 at 4. The DC Bar agrees with this approach:

> Rule 1.8(a) and the commentary thereto are silent on how fairness is to be determined, and whether it is to be determined only by reference to facts and circumstances existing at the time the arrangement is accepted by the parties, or by reference to subsequent developments (for example, a huge appreciation in the value of the shares received as fees such that the lawyer is effectively compensated at 100-fold the reasonable value of his services). For ethics purposes (and not for purposes of assessing common law fiduciary duties), we believe that the "fairness" of the fee arrangement should be judged at the time of the engagement. In other words, if the fee arrangement is "fair and reasonable to the client" at the time of the engagement, no ethical violation could occur if subsequent events, beyond the control of the lawyer, caused the fee to appear unfair or unreasonable.

See also Restatement (3d) of the Law Governing Lawyers, § 126, Comment e (2000) ("Fairness is determined based on facts that reasonably could be known at the time of the transaction, not as facts later develop.").

Therefore, any fee arrangement that charges fees in cryptocurrency, or that allows or requires a client to either provide an advance fee or accept a settlement payment from a party in cryptocurrency, should be assessed for fairness at the time that it is agreed upon, based on the facts then available.

WHAT DISCLOSURES TO THE CLIENT DOES RULE 1.8(a) REQUIRE?

At the very least, Rule 1.8(a) requires the lawyer to disclose to the client the risks associated with accepting cryptocurrency as payment of an advance fee and how those risks will be addressed. Particularly, what happens if the value of the cryptocurrency rises above or falls below the actual currency value of the legal services agreed upon by the parties? The information that a lawyer must disclose will vary, of course. However, as the DC Bar Ethics Committee recommends:

> a lawyer accepting cryptocurrency should consider including a clear explanation of how the client will be billed (i.e., in dollars or cryptocurrency); whether and how frequently cryptocurrency held by the lawyer will be calculated in dollars, or otherwise trued-up or adjusted for accounting purposes and whether, upon that accounting, market increases and decreases in the value of the cryptocurrency triggers obligations by either party; how responsibility for payment of cryptocurrency transfer fees (if any) will be allocated; which cryptocurrency exchange platform will be utilized to determine the value of cryptocurrency upon receipt and, in the case of advance fees, as the representation proceeds (i.e., as fees are earned) and upon its termination; and who will be responsible if cryptocurrency accepted by the lawyer in settlement of the client's claims loses value and cannot satisfy third party liens.

SAFEKEEPING CLIENT PROPERTY UNDER RULE 1.15 — COMPETENTLY SAFEGUARDING CRYPTOCURRENCY

Comment [1] to Virginia Rule 1.15 states that a lawyer should safekeep the property of clients and third parties with the care required of a professional fiduciary. The Rule also requires segregation of client and third-party property from the property of the lawyer. As a fiduciary, the lawyer may not commingle, misappropriate, or convert to the lawyer's personal use property that has been entrusted to the lawyer under Rule 1.15.

The first Rule of Professional Conduct, Rule 1.1, requires that a lawyer must act competently in representing a client. Ancillary to that rule, Comment [6] states that the lawyer "should pay attention to the benefits and risks of relevant technology." Applying these principles, several points require discussion.

Before accepting cryptocurrency by a lawyer, the duty of competence requires the lawyer to have the knowledge and skill to understand the risks associated with this technology, and safeguard against the many ways cryptocurrency may be stolen or lost. D.C.

Bar Ethics Opinion 378, *supra*. "Because blockchain transactions are unregulated, uninsured, anonymous, and irreversible, cryptocurrency is regularly targeted for digital fraud and theft." *Id.*

Unlike traditional funds deposited in a lawyer's trust account, cryptocurrency is not FDIC insured. Cryptocurrency online wallets and exchange platforms may be fraudulent. Even legitimate online wallets and platforms may be hacked. Transactions stored on a digital (hot) wallet connected to an online network may be vulnerable to malware and hacking.

The private key is very important, because if lost or stolen, the cryptocurrency is likely permanently inaccessible. The user must keep the private key secret, not share it with anyone and store it in a safe place. Some recommend a "cold wallet" to store cryptocurrency more securely. However, even "cold wallets" (offline software, hardware or paper) may be lost, stolen, damaged or destroyed and therefore the lawyer must exercise reasonable care to protect them. Some recommend purchasing a hardware wallet to store cryptocurrency and avoiding using digital wallets that are connected online.

When accepting cryptocurrency for "safekeeping" under Rule 1.15, the lawyer-client agreement should specify that the cryptocurrency remains the property of the client until earned by the lawyer — as does the appreciation or loss on the cryptocurrency. The agreement should address responsibility for the safekeeping, discuss the safekeeping mechanism(s), and allocate responsibility for security and responsibility for storage costs and risk of loss — whether loss of value or actual loss of the property through hacking or loss of the key. Since property held for safekeeping under Rule 1.15 remains property of the client, the client should be specifically allowed to cause the lawyer to sell the cryptocurrency (whether to prevent market losses, appreciate gain in value or otherwise), and to determine the procedures the lawyer should use in doing so.

Assuming the client has the right to direct the lawyer to sell the cryptocurrency, a lawyer should consider and address in the agreement with the client: (1) whether the cryptocurrency should be sold or exchanged in its present state or converted to fiat currency; and, who bears the responsibility for payment of any expenses incurred as a result of any sale, exchange or conversion; (2) what portion of the sale proceeds will be applied to the advance

fee agreed upon by the parties versus what portion will be returned to the client; (3) who bears the risk if the cryptocurrency is sold at a loss or less than the value of the agreed advance fee, i.e., will the client be obligated to replenish any deficiency; and (4) if the direction to sell is incident to the termination of the lawyer-client relationship, what portion of the sales proceeds has been earned by the lawyer and how much the client is owed as a refund. These are some but by no means all of the questions that could arise if the client has directed the lawyer to sell the cryptocurrency.

Once the cryptocurrency can be applied to earned fees, the agreement should state that it becomes the lawyer's property, the lawyer has the risk of gain or loss, and the lawyer makes the decision when and how to sell the cryptocurrency. Any gain recognized by the lawyer on the value will not be credited to the client's future fees.

Many of the same security measures lawyers can be expected to use with cloud-based software and storage apply to handling cryptocurrency. Some important measures include:

- Use a private and secure internet connection and not public wi-fi when making transactions.
- Use a unique and robust password.
- Use two-factor authentication to better secure and verify transactions.
- Keep the security level high and do not install unsecured apps.

CONCLUSION

A lawyer may accept client property including cryptocurrency offered as an advance payment for the lawyer's services, provided the lawyer's fee is reasonable under Rule 1.5, and this business transaction with the client meets the requirements of Rule 1.8(a), namely, that the transaction is fair and reasonable to the client, the transaction and terms are fully disclosed in writing in a manner the client understands, the client is advised of the opportunity to consult with independent counsel, and the client's consent is confirmed in writing. When cryptocurrency is being held by the lawyer as an advance fee, the requirements of Rule 1.15 regarding safekeeping client property apply and require that the lawyer take reasonable steps to secure the client's property against loss, theft, damage or destruction. When cryptocurrency is

used by the client for payment of an earned fee, Rules 1.8(a) and 1.15 do not apply but the lawyer's fee must be reasonable under Rule 1.5.

A Copy,

Teste:

Clerk

TAB 6

Maryland State Bar Association Committee on Ethics, Ethics Docket No. 2022-01: Accepting Cryptocurrency in Payment of Fees. 2022

MARYLAND STATE BAR ASSOCIATION, INC.
COMMITTEE ON ETHICS
ETHICS DOCKET NO. 2022-01
Accepting Cryptocurrency in Payment of Fees

In your letter of October 15, 2021, you requested an opinion concerning the ethical propriety of an attorney accepting cryptocurrency as a retainer and, if allowed, how you must handle that retainer. The Committee on Ethics of the Maryland State Bar Association considered and approved the following as our written opinion on this matter.

QUESTION PRESENTED

May an attorney accept a cryptocurrency retainer in advanced payment of fees, and what are the ethical considerations raised by doing so?

BRIEF CONCLUSION

An attorney may accept cryptocurrency in payment of fees, provided that the fee is reasonable and the fee arrangement—pursuant to which such fees are paid—otherwise complies with the Maryland Attorneys' Rules of Professional Conduct ("MARPC"). See Md. R. Att'y Rule 19-300.1, et seq. (hereinafter "Rule"). However, given the nature of cryptocurrency and its attendant inability to be deposited into an Attorney Trust Account, we caution that alternative fee arrangements involving the receipt of fees paid in cryptocurrency raise a host of potential ethical considerations, and any attorney considering such an arrangement should be careful to ensure that such arrangements are in full compliance with the MARPC.

STATEMENT OF FACTS

As a hypothetical, you have asked us to assume that an attorney is engaged in the representation of clients operating within the cryptocurrency industry and wishes to accept payment of fees in the form of cryptocurrency, rather than in traditional fiat currency (e.g., USD). The attorney's clients typically hold assets in the form of cryptocurrency and prefer to transact business via the direct transfer of cryptocurrency, rather than having to first convert assets to fiat currency. You've further asked us to assume that these clients "are generally unwilling to deposit funds directly into a traditional bank account, including an attorney trust account."

The hypothetical attorney proposes fee agreements where after obtaining informed consent, confirmed in writing, the attorney would establish a "digital wallet" under the attorney's exclusive control for each client. These wallets would have the express and sole purpose of holding a "retainer fee" paid in cryptocurrency assets. Upon establishing the wallet and providing the client with the wallet address, the client would pay the retainer by directly transferring cryptocurrency assets to the newly established wallet. Upon completion of the transfer, the assets would be under the exclusive control of the attorney. Following receipt of the cryptocurrency retainer, the attorney would thereafter debit funds to the attorney's own account as fees are earned, much in the same way that earned fees are debited from retainer funds held in Attorney Trust Accounts.

For the reasons set forth below, we believe your proposal is permissible pursuant to an alternative fee agreement(s) as described in Rule 19-301.15(c).

ANALYSIS/DISCUSSION

We are not the first State Bar Association's Ethics Committee to consider the ethical implications of attorneys receiving payment in cryptocurrency. Ethics Committees in other jurisdictions have taken varied approaches. In general, we agree with the conclusion(s) reached by many committees that accepting payment of fees in the form of cryptocurrency comports with professional ethical obligations, provided that such fees are reasonable and that they otherwise comply with the MARPC. However, due to cryptocurrency's decentralized digital-only nature, we caution that cryptocurrency presents unique challenges to ensuring ethical compliance.

Cryptocurrency's Nature – Funds or Property?

Whether cryptocurrency should be treated as "funds" (i.e., traditional fiat currency) or alternatively as "property" (i.e., a non-currency-commodity) is at the core of many of our concerns. Unlike traditional physical commodities (e.g., gold or silver) and unlike traditional fiat currency (e.g., the U.S. Dollar), Cryptocurrency's digital-only algorithmic existence is "stored" in digital "wallets" maintained by online platforms (i.e., "hot wallets") or offline on a computer's hard drive, a USB [drive], or even paper ("cold wallets"). Assuming you have the wallet internet address, the contents of the wallet—and transactions of interactions with the wallet—are fully transparent and viewable to the public on the blockchain.

Rule 19-404 typically governs the receipt of "funds" by an attorney and requires the deposit of such funds into an Attorney Trust Account:

Except as otherwise permitted by rule or other law, all funds, including cash, received and accepted by an attorney or law firm in this State from a client or third person to be delivered in whole or in part to a client or third person, unless received as payment of fees owed the attorney by the client or in reimbursement for expenses properly advanced on behalf of the client, shall be deposited in an attorney trust account in an approved financial institution. This Rule does not apply to an instrument received by an attorney or law firm that is made payable solely to a client or third person and is transmitted directly to the client or third person.

Id.

Similarly, Rule 19-301.15(a) typically requires that "funds" be kept in an Attorney Trust Account:

(a) An attorney shall hold property of clients or third persons that is in an attorney's possession in connection with a representation separate from the attorney's own property. Funds shall be kept in a separate account maintained pursuant to Title 19, Chapter 400 of the Maryland Rules, and records shall be created and maintained in accordance with the Rules in that Chapter . . . .

Id.

However, 19-301.15(a) goes on to recognize that property assets, unlike "funds," by nature are incapable of deposit into client trust accounts and specifies how to ethically safekeep such property:

Other property shall be identified specifically as such and appropriately safeguarded, and records of its receipt and distribution shall be created and maintained. Complete records of the account funds and of other property shall be kept by the attorney and shall be preserved for a period of at least five years after the date the record was created.

Id.

The U.S. Internal Revenue Service ("IRS") describes "virtual currency," i.e., cryptocurrency, as

"a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value," and treats cryptocurrency as property, rather than currency, for federal tax purposes. Despite having no physical existence and theoretically being "spendable" like fiat currency, cryptocurrency is more similar to a commodity, such as gold, in that its exchange value is tied directly to market demand.

For these reasons, we believe that cryptocurrency should be treated as "property" rather than "funds," for the purposes of ethical analysis. Thus, neither the provisions of Title 19, Chapter 400, nor the provisions of Rule 19-301.15 require that cryptocurrency assets be deposited into trust accounts, but rather permit attorneys to "appropriately safeguard" such property, (i.e., with the care required of a professional fiduciary). See Rule 19-301.15 at cmt. [1]. In accordance with Rule 19-301.15(a), an attorney's fiduciary obligation to take necessary steps to appropriately safeguard cryptocurrency, as digital property, should be carefully considered and as required by Rule 19-301.15 the attorney must identify the cryptocurrency specifically as trust property and maintain the required records.

Alternative Fee Arrangements & Accepting Advanced Payment of Fees

Legal fees are typically paid in funds (i.e., fiat currency), rather than in property. As a result, an advanced payment received by an attorney must generally be deposited into a client trust account under Maryland Rule 19-301.15(c) and may only be withdrawn as fees are earned or expenses incurred. However, 19-301.15(c) also allows attorneys and clients to agree to alternative fee arrangements, provided that clients give informed consent, confirmed in writing:

(c) Unless the client gives informed consent, confirmed in writing, to a different arrangement, an attorney shall deposit legal fees and expenses that have been paid in advance into a client trust account and may withdraw those funds for the attorney's own benefit only as fees are earned or expenses incurred.

Id.

Similarly, Comment 4 to Rule 19-301.5 speaks directly to the ability of an attorney to ethically agree to an alternative fee arrangement, whereunder the attorney will receive a property asset—in this case cryptocurrency– in the advanced payment of fees:

An attorney may require advance payment of a fee, but is obliged to return any unearned portion. An attorney may accept property in payment for services, such as an ownership interest in an enterprise, providing this does not involve acquisition of a proprietary interest in the cause of action or subject matter of the litigation contrary to Rule 19-301.8(i). However, a fee paid in property instead of money may be subject to the requirements of Rule 19-301.8(a) because such fees often have the essential qualities of a business transaction with the client.

Id.

Thus, accepting advanced payment of fees in cryptocurrency may be ethical, provided that any unearned portion of the advanced payment is returned at the conclusion of representation, and assuming that the attorney complies with 19-301.15(c) and 19-301.8(a) prior to accepting the advanced retainer. Any fee arrangement, regardless of whether it is paid in property or in funds, must be reasonable pursuant to Rule 19-301.5.

Informed Consent

Compliance with Rule 19-301.15(c) and 19-301.8(a), as discussed in the preceding section, is dependent upon obtaining informed consent, confirmed in writing. Although "Informed Consent" is defined by 19-301.0(f), we believe Comment 6 to Rule 19-301.0 provides the best guidance as to what actions an attorney must take in order to obtain informed consent:

Many of the Maryland Attorneys' Rules of Professional Conduct require the attorney to obtain

the informed consent of a client or other person (e.g., a former client or, under certain circumstances, a prospective client) before accepting or continuing representation or pursuing a course of conduct. The communication necessary to obtain such consent will vary according to the Rule involved and the circumstances giving rise to the need to obtain informed consent. The attorney must make reasonable efforts to ensure that the client or other person possesses information reasonably adequate to make an informed decision. Ordinarily, this will require communication that includes a disclosure of the facts and circumstances giving rise to the situation, any explanation reasonably necessary to inform the client or other person of the material advantages and disadvantages of the proposed course of conduct and a discussion of the client's or other person's options and alternatives. In some circumstances it may be appropriate for an attorney to advise a client or other person of facts or implications already known to the client or other person to seek the advice of another attorney. An attorney need not inform a client or other person of facts or implications already known to the client or other person; nevertheless, an attorney who does not personally inform the client or other person assumes the risk that the client or other person is inadequately informed and the consent is invalid. In determining whether the information and explanation provided are reasonably adequate, relevant factors include whether the client or other person is experienced in legal matters generally and in making decisions of the type involved, and whether the client or other person is independently represented by another attorney in giving the consent. Normally, such persons need less information and explanation than others, and generally a client or other person who is independently represented by another attorney in giving the consent should be assumed to have given informed consent.

Id. (internal citations omitted).

At its core, ethically accepting cryptocurrency (as an advanced retainer, pursuant to an alternative fee agreement, with informed consent confirmed in writing) turns first on the question of whether the consent obtained is truly informed. Attorneys considering such arrangements must ensure that they take appropriate steps to ascertain and confirm that their clients have the information necessary to make an informed decision, including the material risks and benefits and potential alternatives. Obtaining such informed consent in the context of fees paid in cryptocurrency may require substantially more effort on the part of attorneys, as clients will need to first understand the nature of cryptocurrency. Secondary to obtaining informed consent, all efforts should be made to exhaustively address contingencies or issues that may arise due to the nature of the property asset, particularly because cryptocurrencies and other digital assets may give rise to novel issues that may not be initially contemplated. Accepting fees paid in cryptocurrency will ultimately require substantially more effort on the part of attorneys, as clients will need to understand the attorney's obligations as they relate to acceptance of non-fiat retainers and the parameters of the agreement should be exhaustively documented.

CONCLUSION

Under the MARPC, you may accept advanced retainer fees in the form of cryptocurrency in lieu of fiat currency. Before accepting any such alternate payment arrangement, you must ensure the fee is reasonable and that the client provides informed written consent and understands the nature of blockchain transactions. Attorneys who accept retainers in cryptocurrencies should be competent in utilizing the technology and able to protect the client's assets (e.g., safekeep the client's property as required by Rule 19-301.15). In this case, competence requires that attorneys understand and safeguard against the many ways cryptocurrency can be stolen or lost. In the

same way an attorney might be disciplined for depositing a client retainer paid in fiat currency into their personal account or the firm's operating account, an attorney accepting a cryptocurrency retainer could be disciplined for falling prey to a phishing attack, for losing access to the wallet containing the funds, or for simply sending funds to be disbursed back to the client to the wrong address. Because the cryptocurrency industry is unregulated, uninsured, anonymous, and irreversible, it is particularly important for you to appropriately safeguard the cryptocurrency retainer against theft, loss or mishandling, or other similar risks. We hope this response is helpful. Thank you for contacting the Committee on Ethics.
Very truly yours,

MSBA COMMITTEE ON ETHICS
REFERENCES:
Rules Cited:
MARPC Rule 19-301.0
MARPC Rule 19-301.5
MARPC Rule 19-301.8
MARPC Rule 19-301.15
Ethics Dockets Cited:
Nebraska Ethics Advisory Opinion for Lawyers No. 17-03
D.C. Bar Ethics Opinion 378
New York City Bar Association Formal Opinion 2019-05
Other Authority Cited:
'Is It Ethical for Lawyers to Accept Bitcoins and Other Cryptocurrencies?' Virginia State Bar Journal – June 2018, pp. 24-25, contd. on p. 30 (republished by North Carolina State Bar Journal – September 2018, pp. 36-37).
DATE APPROVED BY COMMITTEE: 2/16/2022

TAB 7

Ohio Board of Professional Conduct Opinion 2022-07: Lawyer Accepting and Holding Cryptocurrency in Escrow. August 5, 2022

Ohio Board of Professional Conduct

OPINION 2022-07
Issued August 5, 2022

Lawyer Accepting and Holding Cryptocurrency in Escrow[1]

SYLLABUS: A lawyer may accept and hold cryptocurrency in escrow when related to the representation of a client or for a third party through a law-related business. A lawyer must maintain the requisite technological competence and employ appropriate safeguards against property loss when holding cryptocurrency in escrow.

[1] This opinion is limited to the receipt of cryptocurrency to be held in escrow by a lawyer and not for the payment of a lawyer's fees.

Ohio Board of Professional Conduct

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OPINION 2022-07
Issued August 5, 2022

Lawyer Accepting and Holding Cryptocurrency in Escrow[1]

SYLLABUS: A lawyer may accept and hold cryptocurrency in escrow when related to the representation of a client or for a third party through a law-related business. A lawyer must maintain the requisite technological competence and employ appropriate safeguards against property loss when holding cryptocurrency in escrow.

APPLICABLE RULES: Prof.Cond.R. 1.1, 1.2, 1.4, 1.15, 5.7

QUESTION PRESENTED:

Whether a lawyer may accept and hold cryptocurrencies in escrow for clients and third parties.

OPINION:

A lawyer maintains an international transactional law practice and frequently holds client or third-party funds in escrow. Many of the lawyer's international clients prefer to use cryptocurrency for business transactions and desire for the lawyer to hold the cryptocurrency in escrow. Because financial institutions do not accept or exchange cryptocurrency, the lawyer is unable to place cryptocurrency in his lawyer's trust account.

[1] This opinion is limited to the receipt of cryptocurrency to be held in escrow by a lawyer and not for the payment of a lawyer's fees.

Cryptocurrency is a digital, encrypted, and decentralized medium of exchange with an equivalent value in fiat currency. Cryptocurrency relies on blockchain technology, a type of shared peer-to-peer network that stores data in blocks and tracks of all transactions. Cryptocurrency is stored in an electronic format commonly known as a "wallet." A person receiving cryptocurrency from another person uses a "public key" that identifies where the currency is to be sent. The sender uses a "private key" that authorizes changes in debits and credits to each party's wallet. Cryptocurrency transactions are largely unregulated, relatively anonymous, and irreversible. The price of cryptocurrency is extremely volatile and subject to market fluctuation. *See generally*, Neb. Ethics Adv. Op. 17-03 (2017), D.C. Bar Ethics Op. 378 (2020).

Receiving and Holding Digital Currencies in Trust or in Escrow

Lawyers are required to hold the property of clients or third persons separate from the lawyer's own property. Prof.Cond.R. 1.15(a). Property in the form of monetary funds must be kept in a separate interest-bearing account in an Ohio financial institution and designated as a "client trust account," "IOLTA account," or other identifiable fiduciary title. *Id*. However, only monetary funds may be placed in an interest-bearing account. R.C. 4705.09. Cryptocurrency is treated as property and not as monetary funds by the Internal Revenue Service. IRS Notice 2014-21. Unless cryptocurrency is converted into U.S. funds upon receipt by a lawyer, it cannot be deposited in a client trust account.

Because cryptocurrency is treated as property, the Board concludes that it may be held by a lawyer for clients or third persons in connection with a representation or law related business. A lawyer accepting cryptocurrency is required to segregate client or third-party property from their own property, properly identify the property, and maintain a record of when the property was received, the person or entity for whom the property is held, and the date of any distributions. Prof.Cond.R. 1.15(a). The Board recommends that a lawyer maintain separate records that document all exchanges or other dispositions of cryptocurrency and the value of the cryptocurrency at the time of each transfer or disposition. In addition, a lawyer must also "promptly render a full accounting regarding * * * [the] property," including cryptocurrency held by the lawyer, when requested by a client or third party. Prof.Cond.R. 1.15(d). Records related to the holding of cryptocurrency must be held by the lawyer for seven years after disposition and may be maintained electronically. Prof.Cond.R. 1.15(a); Prof.Cond.R. 1.15, cmt.[1].

Technological Competency

In order to maintain the requisite knowledge and skill required of a lawyer, it is important for the lawyer to keep abreast of the risks associated with the technology used to transfer and hold cryptocurrency in his or her practice. Prof.Cond.R. 1.1, cmt.[8]. Just like other client property, a lawyer storing cryptocurrency in escrow must use reasonable care to minimize the risk of loss to client's or third parties' property. *See* Prof.Cond.R. 1.15,cmt.[1]. More specifically, a lawyer is required to "appropriately safeguard property" in a "suitable place of safekeeping." Prof.Cond.R. 1.15(a). There are several recommended methods to safeguard cryptocurrency held in escrow (*e.g.,* cold storage wallets, encryption and back up of private keys, multi-signature accounts) that should be thoroughly researched and carefully considered by lawyers before accepting cryptocurrency. Additionally, a lawyer should inform clients of the apparent and inherent risks of holding and transferring cryptocurrency and explain the steps the lawyer will undertake to safeguard the client's property. Prof.Cond.R. 1.4(a).

Avoiding Participation in Illegal Activity

Because of the relative anonymity of cryptocurrency transactions, the use of a lawyer's escrow services may be sought after by persons seeking to engage in money laundering or other fraud. In order to prevent unknowingly assisting in illegal activity, a lawyer should require a detailed written escrow agreement that identifies the parties to the transaction (possibly using know-your-customer identity verification methods) as well as the underlying transaction for which the escrow account will be used. *See* Prof.Cond.R. 1.2(d)(1).

Lawyers Holding Cryptocurrency in Escrow in a Law-related Business

Some lawyers may be retained to provide escrow services that are unrelated to the representation of a client such as a paymaster for international transactions. When a lawyer serves only as an escrow agent or paymaster through a business that provides a law-related service, the service is not governed by the Rules of Professional Conduct unless the services provided are not distinct from the lawyer's provision of legal services to the client. Prof.Cond.R. 5.7(a)(1). A lawyer providing a law-related service must take reasonable steps to ensure that the business client is aware that the services provided are

not legal services and that the protections of the client-lawyer relationship are unavailable. Prof.Cond.R. 5.7(a)(2).

TAB 8

Pennsylvania Department of Banking Services Guidance Letter: Money Transmitter Act Guidance for Virtual Currency Businesses. 2019.

Money Transmitter Act Guidance for Virtual Currency Businesses

The Pennsylvania Department of Banking and Securities ("DoBS") has received multiple inquiries from entities engaged in various forms of virtual currency exchanges. As the DoBS will not be responding to these requests for guidance on a case-by-case basis, the DoBS is providing the following guidance on the applicability of the Money Transmission Business Licensing Law, otherwise known as the Money Transmitter Act ("MTA"), to virtual currency exchanges.

What Constitutes "Money" Under the MTA?

The MTA defines "money" as "currency or legal tender or any other product that is generally recognized as a medium of exchange." Additionally, Pennsylvania law has defined money as "[l]awful money of the United States" and "[a] medium of exchange currently authorized or adopted by a domestic or foreign government." See 1 Pa. C.S. §1991; see also 13 Pa. C.S. §1201(b)(24). Thus, only fiat currency, or currency issued by the United States government, is "money" in Pennsylvania. Virtual currency, including Bitcoin, is not considered "money" under the MTA. To date, no jurisdiction in the United States has designated virtual currency as legal tender.

When Is a Money Transmitter License Required Under the MTA?

Section 2 of the MTA provides that "[n]o person shall engage in the business of transmitting money by means of a transmittal instrument for a fee or other consideration with or on behalf of an individual without first having obtained a license from the [DoBS]." 7 P.S.§6102. A "person" as defined in the MTA "includes an individual or an organization…" Id. at 6101(1). Although the "business of transmitting" is not defined in the MTA, the plain meaning of the word "transmit" is to "send or transfer from one person or place to another." See BLACK'S LAW DICTIONARY, 1499 (6th ed. 1990); 1 Pa. C.S. §1903(a). Thus, in order to "transmit" money under the MTA, fiat currency must be transferred with or on behalf of an individual to a 3rd party, and the money transmitter must charge a fee for the transmission.

Virtual Currency Trading Platforms

Several of the entities requesting guidance on the applicability of the MTA are web-based virtual currency exchange platforms ("Platforms"). Typically, these Platforms facilitate the purchase or sale of virtual currencies in exchange for fiat currency or other virtual currencies, and many Platforms permit buyers and sellers of virtual currencies to make offers to buy and/or sell virtual currencies from other users. These Platforms never directly handle fiat currency; any fiat currency paid by or to a user is maintained in a bank account in the Platform's name at a depository institution.

Under the MTA, these Platforms are not money transmitters. The Platforms, while never directly handling fiat currency, transact virtual currency settlements for the users and facilitate the change in ownership of virtual currencies for the users. There is no transferring money from a user to another user or 3rd party, and the Platform is not engaged in the business of providing payment services or money transfer services.

Virtual Currency Kiosks, ATMs, and Vending Machines

Similarly, entities operating virtual currency kiosks, ATMs, and vending machines ("Kiosks") have also sought direction from the DoBS as to whether these entities would be "money transmitters" under the MTA. Some Kiosks are one-way systems which, for a transaction fee, dispense virtual currency in exchange for fiat currency, while others are two-way systems which, for a transaction fee, exchange

both fiat currency for virtual currency and virtual currency for fiat currency. In both the one-way and two-way Kiosk systems, there is no transfer of money to any third party. The user of the Kiosk merely exchanges fiat currency for virtual currency and vice versa, and there is no money transmission. Thus, the entities operating the Kiosks would not be money transmitters under the MTA.

TAB 9

FTC v. Dluca, No. 0:18-CV-60379 (S.D. Fla. Mar. 12, 2018); and

Fed. Trade Comm'n v. Dluca, No. 18-60379-CIV, 2018 WL 1830800, at *1 (S.D. Fla. Feb. 28, 2018), *report and recommendation adopted*, No. 0:18-CV-60379-KMM, 2018 WL 1811904 (S.D. Fla. Mar. 12, 2018)

2018 WL 1830800
Only the Westlaw citation is currently available.
United States District Court, S.D. Florida.

FEDERAL TRADE COMMISSION, Plaintiff,

v.

Thomas DLUCA, individually and also d/b/a Bitcoin Funding Team and My7Network, Louis Gatto, individually and also d/b/a Bitcoin Funding Team and My7Network, Eric Pinkston, individually and also d/b/a Bitcoin Funding Team and My7Network, and Scott Chandler, individually and also d/b/a Bitcoin Funding Team and JetCoin, Defendants.

No. 18-60379-CIV-MOORE/SNOW
|
Signed 02/28/2018

Attorneys and Law Firms

Jason C. Moon, Susan E. Arthur, M. Hasan Aijaz, U.S. Federal Trade Commission, Dallas, TX, for Plaintiff.

Charles Woodward Throckmorton, V, Carlton Fields Jorden Burt, P.A., Michael Domenic Padula, Miami, FL, David Joseph Braun, Pembroke Pines, FL, David DiPietro, Di Pietro Partners, LLP, Fort Lauderdale, FL, for Defendants.

REPORT AND RECOMMENDATION ON FIRST AMENDED *EX PARTE* TEMPORARY RESTRAINING ORDER WITH ASSET FREEZE, OTHER EQUITABLE RELIEF, AND ORDER TO SHOW CAUSE WHY A PRELIMINARY INJUNCTION SHOULD NOT ISSUE (ECF No. 15)

LURANA S. SNOW, UNITED STATES MAGISTRATE JUDGE

***1** Plaintiff, the Federal Trade Commission ("FTC"), has filed its Complaint for Permanent Injunction and Other Equitable Relief pursuant to Section 13(b) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 53(b) (Docket No. 1), and has moved, pursuant to Fed. R. Civ. P. 65(b), for an *ex parte* temporary restraining order, asset freeze, other equitable relief, and an order to show cause why a preliminary injunction should not issue against Thomas Dluca, individually and also doing business as Bitcoin Funding Team and My7Network; Louis Gatto, individually and also doing business as Bitcoin Funding Team and My7Network; Eric Pinkston, individually and also doing business as Bitcoin Funding Team and My7Network; and Scott Chandler, individually and also doing business as Bitcoin Funding Team and JetCoin (collectively, "Defendants"). (Docket No. 15.)

FINDINGS OF FACT

The Court, having considered the Complaint, the *ex parte* motion for a Temporary Restraining Order, declarations, exhibits, and memorandum of points and authorities filed in support thereof, and being otherwise advised, finds that:

A. This Court has jurisdiction over the subject matter of this case, and there is good cause to believe that it will have jurisdiction over all parties hereto and that venue in this district is proper.

B. Section 13(b) of the FTC Act, 15 U.S.C. § 53(b)(2), authorizes this Court to grant the FTC a preliminary injunction upon a showing that, weighing the equities and considering the FTC's ultimate likelihood of success, a preliminary injunction is in the public interest.

C. "Unlike private litigants, the FTC need not demonstrate irreparable injury in order to obtain injunctive relief." *FTC v. IAB Mktg. Assocs., LP,* 746 F.3d 1228, 1232 (11th Cir. 2014). When a district court balances the public interest against a private interest, the public interest should receive greater weight. *FTC v. World Travel Vacation Brokers*, 861 F.2d 1020, 1030 (7th Cir. 1988); *FTC v. USA Beverages, Inc.*, 2005 U.S. Dist. LEXIS 39075, at *15 (S.D. Fla. 2005).

D. A proper balance of the equities in this matter favors the FTC. Based upon the audio and video recordings, website screen shots, website captures, consumer declarations, investigator declarations, and expert declaration, and other evidence submitted by the FTC, there is good cause to believe that:

1. Defendants are violating and, unless enjoined by this Court, will continue to violate Section 5(a) of the FTC Act;

2. Consumers nationwide have suffered and, unless enjoined by this Court, will continue to suffer harm, including economic injury, as a result of Defendants' violations of Section 5(a) of the FTC Act;

3. Defendants have received and, unless enjoined by this Court, will continue to receive ill-gotten gains as a result of their violations of Section 5(a) of the FTC Act; and

4. The private interests of Defendants do not outweigh the public interest in enjoining future law violations, protecting assets or documents, or preserving the Court's ability to award effective full and final relief.

***2** E. The FTC has shown a likelihood that it will ultimately succeed on the merits. Based upon the audio and video recordings, website screen shots, website captures, consumer declarations, investigator declarations, expert declaration, and other evidence submitted by the FTC, there is good cause to believe that Defendants Dluca, Gatto, Pinkston, and Chandler have engaged in and are likely to engage in acts or practices that violate Section 5(a) of the FTC Act by:

1. falsely representing to consumers that Bitcoin Funding Team and/or My7Network were *bona fide* money-making opportunities, when, in fact, these programs were chain referral schemes; and

2. falsely representing that participants in the Bitcoin Funding Team, My7Network, or JetCoin purported money-making schemes were likely to earn substantial income.

F. This Court finds that the public interest is served by:

1. Enjoining deceptive or unfair acts or practices that violate the law;

2. Maintaining the *status quo* over assets and business documents relating to Defendants' alleged law violations until a fair and impartial hearing may be held; and

3. Preserving the Court's ability to award full and effective final relief at trial or other disposition of this matter.

G. The Federal Rules of Civil Procedure permit this Court to issue an *ex parte* temporary restraining order where specific facts clearly show a likelihood that immediate and irreparable injury, loss, or damage will result if notice is provided. Fed. R. Civ. P. 65(b)(1). Irreparable injury may be presumed in a statutory law enforcement action. "No specific or immediate showing of the precise way in which violation of the law will result in a public harm is required." *United States v. Odessa Union Warehouse Co-op*, 833 F.2d 172, 175 (9th Cir. 1987). Nonetheless, this Court finds that Plaintiff has shown that Defendants are likely to dissipate assets and destroy business documents, which would cause immediate and irreparable injury, loss, or damage to this Court's ability to award effective final relief at trial or other disposition of this matter. In making this determination, the Court relies upon the following:

1. In the FTC's law enforcement experience, defendants who receive notice of the filing of an action by the FTC often attempt to immediately dissipate assets or destroy documents. FTC counsel has provided, in his Fed. R. Civ. P. 65(b)(1)(B) declaration, a number of examples of defendants who have or have attempted to interfere with the Court's ability to award full and effective final relief by dissipating assets or destroying documents. Such conduct is likely in cases such as this, where Defendants have generated millions of dollars using business practices permeated by deception;

2. The use of cryptocurrency in the programs promoted by Defendants poses a heightened risk of asset dissipation. Bitcoin and other cryptocurrencies are circulated through a decentralized computer network, without relying on traditional banking institutions or other clearinghouses. This independence from traditional custodians makes it difficult for law enforcement to trace or freeze cryptocurrencies in the event of fraud or theft; and

3. Defendants claim that the schemes they have promoted have expanded into dozens of countries. If Defendants were provided notice of this action, it would be a simple matter for them to transfer their bitcoin or other cryptocurrency to unidentified recipients outside the traditional banking system, including contacts in foreign countries, and effectively put it beyond the reach of this Court.

***3** H. The FTC has established that it is likely to succeed in proving that Defendants collectively have engaged in a course of conduct to deceive consumers nationwide out of millions of dollars. The same factors that justify issuance of relief on an *ex parte* basis also establish that an asset freeze and other equitable relief are appropriate.

I. Because the balance of the equities tips in the FTC's favor, the FTC is likely to ultimately succeed on the merits of its complaint, and immediate and irreparable harm, including the dissipation of assets and destruction of documents, is probable

absent immediate injunctive relief, this Court finds that an *ex parte* temporary restraining order with an asset freeze and other equitable relief is warranted and in the public interest.

J. This Court has authority to issue this Order pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b); Fed. R. Civ. P. 65; and the All Writs Act, 28 U.S.C. § 1651.

K. Under Fed. R. Civ. P. 65(c), no security is required of any agency of the United States for issuance of a temporary restraining order.

Based upon the foregoing, it is hereby RECOMMENDED that the Honorable Michael K. Moore enter the following Order:

DEFINITIONS

For the purpose of this Order, the following definitions shall apply:

A. **"Asset"** or **"Assets"** means any legal or equitable interest in, right to, or claim to any item of economic value, in whole or part, whether tangible or intangible, including, but not limited to, accounts, accounts receivable, cash, certificates of deposit, chattels, checks, contracts, credits, currency, cryptocurrency, fixtures, funds, equipment, income, intellectual property, inventory, instruments, investments, leaseholds, lines of credit, mail, notes, personal property, real property, revenues, securities, shares of stock, trusts, or any interest therein, whether located within or outside the United States.

B. **"Defendant(s)"** means Thomas Dluca, Louis Gatto, Eric Pinkston, and Scott Chandler, individually, collectively, or in any combination.

C. **"Document"** is synonymous in meaning and equal in scope to the usage of "document" and "electronically stored information" in Fed. R. Civ. P. 34(a), and includes writings, drawings, graphs, charts, photographs, sound and video recordings, images, Internet sites, web pages, websites, electronic correspondence, including e-mail and instant messages, contracts, accounting data, advertisements, FTP Logs, Server Access Logs, books, written or printed records, handwritten notes, telephone logs, telephone scripts, receipt books, ledgers, personal and business canceled checks and check registers, bank statements, appointment books, computer records, customer or sales databases and any other electronically stored information, including Documents located on remote servers or cloud computing systems, and other data or data compilations from which information can be obtained directly or, if necessary, after translation into a reasonably usable form. A draft or non-identical copy is a separate Document within the meaning of the term.

***4** D. **"Electronic Data Host"** means any person or entity in the business of storing, hosting, or otherwise maintaining electronically stored information. This includes, but is not limited to, any entity hosting a website or server, and any entity providing "cloud based" electronic storage.

E. **"Financial Institution"** means an insured bank, commercial bank or trust company; a private banker, agency or branch of a foreign bank; a credit union or thrift institution; a broker or dealer in securities or commodities, whether or not registered; an investment banker or investment company; a currency exchange or cryptocurrency exchange or service provider; an issuer, redeemer, or cashier of travelers' checks, checks, money orders, or similar investments; participant in the credit card system, including an operator of the credit card system, a credit card processor, a payment processor, a merchant bank, an acquiring bank, an independent sales organization, a third party processor, or a payment gateway; an insurance company; a dealer in precious metals, stones, or jewels; a pawnbroker; a loan or finance company; a licensed sender of money or other person who engages as a business in the transmission of funds; a telegraph company; persons involved in vehicle or real estate sales, closings, or settlements; a casino, or gaming establishment.

F. **"Marketing Program"** includes, but is not limited to, any multi-level marketing program, business opportunity, pyramid marketing scheme, Ponzi scheme, or chain marketing scheme.

G. **"Material"** means likely to affect a person's choice of, or conduct regarding, goods or services.

H. **"Person"** means an individual, organization, Financial Institution, or other legal entity, including, but not limited to, an association, cooperative, corporation, limited liability company, partnership, proprietorship, or trust, or combination thereof.

ORDER

I. PROHIBITED BUSINESS ACTIVITIES

IT IS THEREFORE ORDERED that Defendants, Defendants' officers, agents, employees, and attorneys, and all other persons in active concert or participation with them, who receive actual notice of this Order, whether acting directly or indirectly, in connection with advertising, marketing, promoting, operating, offering for sale, or sale of any Marketing Program, are temporarily restrained and enjoined from:

A. Engaging in, participating in, or assisting others in engaging in or participating in, any Marketing Program that:

1. Pays compensation for recruiting new members;

2. Encourages or incentivizes members to purchase goods or services to maintain eligibility for bonuses, rewards, or commissions rather than for resale or personal use;

3. Pays any compensation related to the purchase or sale of goods or services unless the majority of such compensation is derived from sales to or purchases by Persons who are not members of the Marketing Program; or

4. Constitutes a pyramid scheme or Ponzi scheme;

B. Misrepresenting, or assisting others in misrepresenting, expressly or by implication, that Defendants' Marketing Programs are structured to operate as *bona fide* money-making opportunities; and

C. Misrepresenting, or assisting others in misrepresenting, expressly or by implication, any Material fact, including, but not limited to, that consumers who participate in a Marketing Program will or are likely to receive substantial income.

II. PROHIBITION ON RELEASE OF CUSTOMER INFORMATION

***5 IT IS FURTHER ORDERED** that Defendants, Defendants' officers, agents, employees, and attorneys, and all other persons in active concert or participation with any of them who receive actual notice of this Order by personal service or otherwise, whether acting directly or indirectly, are hereby temporarily restrained and enjoined from:

A. Selling, renting, leasing, transferring, or otherwise disclosing the name, address, birth date, telephone number, electronic mail address, credit card number, bank account number, Social Security number, or other financial or identifying information of any Person that any Defendant obtained in connection with any activity that pertains to the subject matter of this Order; and

B. Benefitting from or using the name, address, birth date, telephone number, electronic mail address, credit card number, bank account number, Social Security number, or other financial or identifying information of any Person that any Defendant obtained in connection with any activity that pertains to the subject matter of this Order.

Provided, however, that Defendants may disclose such financial or identifying personal information to a law enforcement agency, to their attorneys as required for their defense, or as required by any law, regulation, or court order.

III. ASSET FREEZE

IT IS FURTHER ORDERED that Defendants and their officers, agents, employees, and attorneys, and all other persons in active concert or participation with any of them, who receive actual notice of this Order, whether acting directly or indirectly, are hereby temporarily restrained and enjoined from directly or indirectly:

A. Assigning, concealing, converting, disbursing, dissipating, encumbering, granting a lien or security interest or other interest in, liquidating, loaning, pledging, relinquishing, selling, spending, transferring, withdrawing, or otherwise disposing of any Asset that is:

1. owned or controlled, directly or indirectly, by any Defendant;

2. held, in whole or in part, for the benefit of any Defendant;

3. in the actual or constructive possession of any Defendant; or

4. owned, controlled by, in the actual or constructive possession of, or otherwise held for the benefit of, any entity directly or indirectly owned, managed, or

controlled by, or under common control by or with any Defendant;

B. Opening or causing to be opened any safe deposit box, commercial mail box, or storage facility belonging to, for the use or benefit of, under the control of, or subject to access by any Defendant;

C. Incurring charges or cash advances on any credit, debit, or checking card issued in the name, individually or jointly, of any Defendant, or of any entity directly or indirectly owned, managed, or controlled by any Defendant; and

D. Cashing or depositing any Asset derived from any Marketing Program prohibited by this Order.

The Assets affected by this Section shall include: (1) all Assets of Defendants as of the time this Order is entered; and (2) for Assets obtained by Defendants after this Order is entered, if those Assets are derived from any activity that is the subject of the Complaint in this matter or that is prohibited by this Order. This Section does not prohibit the repatriation of foreign Assets specifically required by this Order.

IV. DUTIES OF ASSET HOLDERS AND OTHER THIRD PARTIES

***6 IT IS FURTHER ORDERED** that any Financial Institution or Person that has, or that at any time since January 1, 2014, has had, custody or control over a Document or Asset belonging to, for the use or benefit of, or under the control of or subject to access by any Defendant and who receives actual notice of this Order by personal service or otherwise, whether acting directly or indirectly, shall:

A. Hold, preserve, and retain within its control and prohibit the withdrawal, removal, alteration, assignment, transfer, pledge, encumbrance, disbursement, dissipation, relinquishment, conversion, sale, or other disposal of any Asset, except (1) as directed by further order of this Court, or (2) by written stipulation of the parties;

B. Deny any Person access to any safe deposit box, commercial mail box, or storage facility belonging to, for the use or benefit of, under the control of, or subject to access by any Defendant, either individually, or jointly;

C. Provide Plaintiffs counsel, within three (3) days of receiving a copy of this Order, a sworn statement setting forth:

1. The identification number of each such account or Asset belonging to, for the use or benefit of, under the control of, or subject to access by any Defendant;

2. The balance of each account, or a description of the nature and value of each Asset as of the close of business on the day on which this Order is received, and, if the account or other Asset has been closed or removed, the date closed or removed, the total funds removed or transferred, and the name of the Person to whom such account or Asset was remitted;

3. The identification of any safe deposit box, commercial mail box, or storage facility belonging to, for the use or benefit of, under the control of, or subject to access by any Defendant, individually or jointly; and

4. The cryptographic hash value, time stamp, transaction data, public addresses or other information sufficient to identify, locate, and track cryptocurrency in any blockchain or distributed ledger technology system that is belonging to, for the use or benefit of, under the control of, or subject to access by any Defendant; and

D. Within five (5) business days of receiving a request from Plaintiff's counsel, provide Plaintiff's counsel with all Documents pertaining to such Asset, including, but not limited to, account applications, statements, signature cards, checks, drafts, deposit tickets, transfers to and from accounts, wire transfers, wire transfer instructions, all other debit and credit instruments or slips, currency transaction reports, 1099 forms, and all logs and records pertaining to safe deposit boxes, commercial mail boxes, and storage facilities.

Provided, however, that this Section does not prohibit any repatriation of foreign Assets specifically required by this Order.

V. SERVICE OF THIS ORDER

IT IS FURTHER ORDERED that copies of this Order may be served by any means, including facsimile transmission, electronic mail or other electronic messaging, personal or overnight delivery, U.S. Mail or FedEx, by agents or employees of the Plaintiff, by any law enforcement agency, or by process server, upon any Person that may have

possession, custody, or control of any Asset or Document of any Defendant, or that may be subject to any provision of this Order pursuant to Fed. R. Civ. P. 65(d)(2). For purposes of this Section, service upon any branch, subsidiary, affiliate or office of any entity shall effect service upon the entire entity.

VI. POSTING NOTICE OF LAWSUIT ON WEB SITES

***7 IT IS FURTHER ORDERED** that, within 24 hours of service of this Order, Defendants and each of their successors, assigns, members, officers, agents, employees, and those persons in active concert or participation with them who receive actual notice of this Order, whether acting directly or indirectly, shall take whatever action is necessary to ensure that any website used by any Defendant in connection with the advertising, marketing, and promotion of any Marketing Program, shall:

A. Prominently display the following statement:

> The Federal Trade Commission (FTC) has filed a lawsuit against Thomas Dluca, Louis Gatto, Eric Pinkston, and Scott Chandler, individually and doing business as Bitcoin Funding Team, My7Network, or JetCoin, alleging that they have engaged in deceptive practices in connection with the advertising, marketing, and promotion of purported money-making opportunities. The United States District Court for the Southern District of Florida has issued a Temporary Restraining Order prohibiting the alleged practices. You may obtain additional information directly from the Federal Trade Commission.

B. Provide a hypertext link to the FTC's home page at www.ftc.gov, or another home page designated by counsel for the FTC.

VII. PRODUCTION OF DOCUMENTS, DATA, AND IDENTIFICATION INFORMATION

IT IS FURTHER ORDERED that:

A. Within three (3) days of service of this Order, each Defendant shall produce to the FTC at the Office of the Attorney General – Consumer Protection Division, 110 S.E. 6th Street, 10th Floor, Fort Lauderdale, Florida 33301, or other location designated by the FTC, for inventory and copying, all Documents, computer equipment, and electronically stored information in any Defendant's possession, custody, or control, that contains information about Defendants' operation or promotion of Bitcoin Funding Team, My7Network, JetCoin, or any other money-making opportunity that Defendants promoted or in which Defendants participated since January 1, 2014. The FTC shall return each item produced for inventory or copying to Defendants within five (5) business days from the date and time of any Defendant's delivery of each such item.

Each Defendant, to the extent he has possession, custody, or control of Documents described above, shall produce the Documents as they are kept in the usual course of business. Each Defendant, to the extent he has possession, custody, or control of computer equipment or electronically stored information described above, shall provide the FTC with any necessary means of access to the computer equipment or electronically stored information, including, but not limited to, computer access codes and passwords.

B. Within 48 hours of service of this Order, each Defendant shall:

1. Complete and serve on counsel for the FTC the Electronically Stored Information Statement attached as **Attachment A;** and

2. Identify for Plaintiffs Counsel:

   a. All of Defendants' business premises;

   b. Any non-residence where Documents or electronically stored information related to Defendants' operation or promotion of Bitcoin Funding Team, My7Newtork, JetCoin, or any other money-making opportunity that Defendants promoted or in which Defendants participated are hosted, stored, or otherwise maintained, including, but not limited to, the name and location of any Electronic Data Hosts; and

   c. Any non-residence premises where Assets belonging to any Defendant are stored or maintained.

VIII. FINANCIAL DISCLOSURES AND ACCOUNTING

***8 IT IS FURTHER ORDERED that:**

A. Within five (5) days of service of this Order, each Defendant, shall prepare and deliver to Plaintiff's counsel:

1. A complete and accurate financial statement on the form attached to this Order as **Attachment B** disclosing all personal Assets and providing all required attachments;

2. A complete and accurate cryptocurrency financial statement on the form attached to this Order as **Attachment C;**

3. A complete and accurate consent to release of financial records on the form attached to this Order as **Attachment D;** and

4. A complete and accurate request for copy of tax return on the form attached to this Order as **Attachment E.**

B. Within five (5) business days after service of this Order, each Defendant shall prepare and provide to Plaintiff a complete, accurate, and detailed accounting of each Marketing Program advertised, marketed, promoted, offered for sale, distributed, or sold by or on behalf of Defendants since January 1, 2014, including:

1. A brief description of each Marketing Program;

2. Gross revenues (in U.S. dollars) obtained from the advertising, marketing, or sale of each identified Marketing Program;

3. For any website that Defendants used in connection with advertising, marketing, promoting, operating, offering for sale, or sale of any identified Marketing Program, provide the website address or Uniform Record Locator (URL), website host, website administrator, and the name, address, telephone number, electronic mail address, and website address, of any Person who controls or has controlled the website's content; and

4. The name, address, telephone number, electronic mail address, website address, and contact Person of each Person that: (i) supplied, developed, administered, formulated, or created each identified Marketing Program; (ii) paid Defendants, whether directly or indirectly, for promoting the Marketing Program; and or (iii) disseminated or published any promotional material on behalf of Defendants or received payment from Defendants for arranging in or assisting in such dissemination or publication.

IX. FOREIGN ASSET REPATRIATION

IT IS FURTHER ORDERED that within five (5) days of service of this Order, each Defendant shall:

A. Take all steps necessary to provide Plaintiff's counsel access to all Documents and records that may be held by third parties located outside of the territorial United States of America related to Defendants' operation or promotion of Bitcoin Funding Team, My7Newtork, JetCoin, or any other money-making opportunity that Defendants promoted or in which Defendants participated;

B. Transfer to the territory of the United States all Documents and Assets located in foreign countries which: (1) belong to, are for the use or benefit of, are under the control of any Defendant, individually or jointly; or (2) are held by any Person or entity for the benefit of any Defendant or for the benefit of, any corporation, partnership, asset protection trust, or other entity that is directly or indirectly owned, managed or controlled by any Defendant, individually or jointly; and

***9** C. Hold and retain all repatriated Assets and prevent and disposition, transfer, or dissipation of such Assets except as required by this Order.

X. NON-INTERFERENCE WITH REPATRIATION

IT IS FURTHER ORDERED that Defendants, Defendants' officers, agents, employees, and attorneys, and all other persons in active concert or participation with any of them, who receive actual notice of this Order, whether acting directly or indirectly, are hereby temporarily restrained and enjoined from taking any action that may result in the encumbrance or dissipation of foreign Assets, or in the hindrance of the repatriation required by the Section of this Order entitled “Foreign Asset Repatriation,” including, but not limited to:

A. Sending any communication or engaging in any other act, directly or indirectly, that results in a determination by a foreign trustee or other entity that a “duress” event has occurred under the terms of a foreign trust agreement until such time that all Defendants' Assets have been fully repatriated pursuant to this Order; or

B. Notifying any trustee, protector or other agent of any foreign trust or other related entities of either the existence of this Order, or of the fact that repatriation is required pursuant to a court order, until such time that all Defendants' Assets have been fully repatriated pursuant to this Order.

XI. CONSUMER CREDIT REPORTS

IT IS FURTHER ORDERED that Plaintiff may obtain credit reports concerning any Defendants pursuant to Section 604(a)(1) of the Fair Credit Reporting Act, 15 U.S.C. § 1681 b(a)(1), and that, upon written request, any credit reporting agency from which such reports are requested shall provide them to Plaintiff.

XII. PRESERVATION OF RECORDS

IT IS FURTHER ORDERED that Defendants, Defendants' officers, agents, employees, and attorneys, and all other persons in active concert or participation with any of them, who receive actual notice of this Order, whether acting directly or indirectly, are hereby temporarily restrained and enjoined from altering, concealing, destroying, erasing, falsifying, mutilating, transferring, writing over, or otherwise disposing of, in any manner, directly or indirectly, Documents that relate to: (A) the business practices, Assets, or business or personal finances of any Defendant; or (B) the business practices or finances of entities directly or indirectly under the control of any Defendant.

XIII. REPORT OF NEW BUSINESS ACTIVITY

IT IS FURTHER ORDERED that Defendants, Defendants' officers, agents, employees, and attorneys, and all other persons in active concert or participation with any of them, who receive actual notice of this Order, whether acting directly or indirectly, are hereby temporarily restrained and enjoined from creating, operating, or exercising any control over any business entity, whether newly formed or previously inactive, including any partnership, limited partnership, joint venture, sole proprietorship, or corporation, without first providing Plaintiffs counsel with a written statement disclosing: (A) the name of the business entity; (B) the address, telephone number, and any website used by the business entity; (C) the names of the business entity's officers, directors, principals, managers, and employees; and (D) a detailed description of the business entity's intended activities.

XIV. DISTRIBUTION OF ORDER BY DEFENDANTS

***10 IT IS FURTHER ORDERED** that Defendants shall immediately provide a copy of this Order to each affiliate, telemarketer, marketer, sales entity, successor, assign, member, officer, director, employee, agent, independent contractor, client, attorney, spouse, subsidiary, division, and representative of any Defendant, and shall, within ten (10) days from the date of entry of this Order, provide Plaintiff with a sworn statement that Defendant has complied with this provision of the Order and shall list the names, addresses, telephone numbers, and electronic mail addresses of each Person or entity who received a copy of the Order.

XV. ORDER TO SHOW CAUSE

IT IS FURTHER ORDERED that, pursuant to Fed. R. Civ. P. 65(b), each Defendant shall appear before this Court on the 7th day of March, 2018, at 2:00 o'clock p.m. EST in the courtroom of United States Magistrate Judge Lurana S. Snow, Room 203D, United States District Court, Southern District of Florida, located at 299 East Broward Boulevard, Fort Lauderdale, Florida 33301, to show cause, if there is any, why this Court should not enter a preliminary injunction, pending final ruling on the Complaint against Defendants, enjoining the violations of the law alleged in the Complaint, continuing the freeze of their Assets, and imposing such additional relief as may be appropriate.

XVI. CONDUCT OF THE SHOW CAUSE HEARING

IT IS FURTHER ORDERED that:

A. Unless an evidentiary hearing is requested, Plaintiff's motion for order to show cause why a preliminary injunction should not issue against all Defendants shall be resolved on the pleadings, declarations, exhibits, and memoranda filed by, and oral argument of the parties. A party may request an evidentiary hearing by filing a Notice of Evidentiary Hearing with the Court and providing notice to the opposing party at least five (5) days prior to the scheduled show cause hearing.

The filing of such Notice shall entitle both the requesting party and its opponent to an evidentiary hearing.

B. Defendants shall file with the Court and serve on Plaintiff's counsel any answering pleadings, affidavits, motions, expert reports or declarations, or legal memoranda no later than four (4) days prior to the order to show cause hearing scheduled pursuant to this Order. Plaintiff may file responsive or supplemental pleadings, materials, affidavits, or memoranda with the Court and serve the same on counsel for Defendants no later than one (1) day prior to the order to show cause hearing.

C. In the event that a Notice of Evidentiary Hearing is filed, the parties shall file and serve their Witness Lists and Exhibit Lists at least three (3) days prior to the show cause hearing, and shall provide the parties with copies of all exhibits to be introduced.

XVII. DURATION OF THE TEMPORARY RESTRAINING ORDER

IT IS FURTHER ORDERED that this Order shall expire fourteen (14) days from the date of entry noted below, unless within such time, the Order is extended for an additional period pursuant to Fed. R. Civ. P. 65(b)(2), for good cause shown.

XVIII. RETENTION OF JURISDICTION

IT IS FURTHER ORDERED that this Court shall retain jurisdiction of this matter for all purposes.

DONE AND SUBMITTED, this 28th day of Feb., 2018.

All Citations

Not Reported in Fed. Supp., 2018 WL 1830800

End of Document

TAB 10

CFTC v. Zhao et al., 23-CV-01887 (N.D. Ill.)

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS

Commodity Futures Trading Commission, Plaintiff, v. Changpeng Zhao, Binance Holdings Limited, Binance Holdings (IE) Limited, Binance (Services) Holdings Limited, and Samuel Lim, Defendants.	**CIVIL ACTION NO:** **Hon._____** **Jury Trial Demanded**

COMPLAINT FOR INJUNCTIVE AND OTHER EQUITABLE RELIEF AND CIVIL MONETARY PENALTIES UNDER THE COMMODITY EXCHANGE ACT AND COMMISSION REGULATIONS

Plaintiff Commodity Futures Trading Commission ("CFTC" or "Commission"), an independent federal agency, for its Complaint against Defendants Changpeng Zhao ("Zhao"), Binance Holdings Limited, Binance Holdings (IE) Limited, Binance (Services) Holdings Limited (collectively "Binance" or the "Binance platform"), and Samuel Lim ("Lim") (collectively, "Defendants"), alleges as follows:

I. SUMMARY

1. Binance operates the world's largest centralized digital asset exchange, emerging through an opaque web of corporate entities, all of which are ultimately controlled by Zhao, the Chief Executive Officer ("CEO") of Binance, and constitute a common enterprise called "Binance" or the "Binance ecosystem." Much of Binance's reported trading volume, and its profitability, has come from its extensive solicitation of and access to customers located in the

United States, including in this District, that enter into several different types of digital asset spot and derivative transactions involving commodities in interstate commerce on the Binance platform.

2. Beginning no later than July 2019 and continuing through the present (the "Relevant Period"), Binance, under Zhao's direction and control and with Lim's willful and substantial assistance, has solicited and accepted orders, accepted property to margin, and operated a facility for the trading of futures, options, swaps, and leveraged retail commodity transactions involving digital assets that are commodities including bitcoin (BTC), ether (ETH), and litecoin (LTC) for persons in the United States.

3. Since the launch of its platform in 2017, Binance has taken a calculated, phased approach to increase its United States presence despite publicly stating its purported intent to "block" or "restrict" customers located in the United States from accessing its platform. Binance's initial phase of strategically targeting the United States focused on soliciting retail customers. In a later phase, Binance increasingly relied on personnel and vendors in the United States and actively cultivated lucrative and commercially important "VIP" customers, including institutional customers, located in the United States. All the while, Binance, Zhao, and Lim, the platform's former Chief Compliance Officer ("CCO"), have each known that Binance's solicitation of customers located in the United States subjected Binance to registration and regulatory requirements under U.S. law. But Binance, Zhao, and Lim have all chosen to ignore those requirements and undermined Binance's ineffective compliance program by taking steps to help customers evade Binance's access controls.

4. Defendants have disregarded applicable federal laws while fostering Binance's U.S. customer base because it has been profitable for them to do so. For example, according to

Binance's own documents for the month of August 2020 the platform earned $63 million in fees from derivatives transactions and approximately 16% of its accounts were held by customers Binance identified as being located in the United States. By May 2021, Binance's monthly revenue earned from derivatives transactions increased to $1.14 billion. Binance's decision to prioritize commercial success over compliance with U.S. law has been, as Lim paraphrased Zhao's position on the matter, a "biz decision."

5. Binance purposefully obscures the identities and locations of the entities operating the trading platform. For example, Binance's customer-facing "Terms of Use," purports to be a contract between the customer and something simply called the "Binance operators," which is a term that has no concrete meaning. While Binance has maintained offices in numerous locations, including Singapore, Malta, Dubai, and Tokyo at various times during the Relevant Period, Binance intentionally does not disclose the location of its executive offices. Instead, Zhao has stated that Binance's headquarters is wherever he is located at any point in time, reflecting a deliberate approach to attempt to avoid regulation. Zhao explained this strategy during a June 2019 internal meeting, stating that Binance conducts its operations through various entities incorporated in numerous jurisdictions to "keep countries clean [of violations of law]" by "not landing .com anywhere. This is the main reason .com does not land anywhere."

6. Zhao, Lim, and other members of Binance's senior management have failed to properly supervise Binance's activities and, indeed, have actively facilitated violations of U.S. law, including by assisting and instructing customers located in the United States to evade the compliance controls Binance purported to implement to prevent and detect violations of U.S. law. Binance and its officers, employees, and agents have instructed U.S. customers to use virtual private networks ("VPNs") to obscure their location; allowed customers that had not

submitted proof of their identity and location to continue to trade on the platform long after announcing such conduct was prohibited; and directed VIP customers with ultimate beneficial owners, key employees who control trading decisions, trading algorithms, and other assets all located in the United States to open Binance accounts under the name of newly incorporated shell companies to evade Binance's compliance controls.

7. Despite Binance's solicitation of and reliance on customers located in the United States to generate revenue and provide liquidity for its various markets, Binance has never been registered with the CFTC in any capacity and has disregarded federal laws essential to the integrity and vitality of the U.S. financial markets, including laws that require the implementation of controls designed to prevent and detect money laundering and terrorism financing, in violation of the Commodity Exchange Act ("Act" or "CEA"), 7 U.S.C. §§ 1–26, and the CFTC Regulations ("Regulations"), 17 C.F.R. pts. 1–190 (2022).

8. Throughout the Relevant Period, and through the operation of the Binance platform, Defendants Binance, aided and abetted by Lim, and Zhao have violated core provisions of the CEA and the Regulations, including:

i. offering, entering into, confirming the execution of, or otherwise dealing in, off-exchange commodity futures transactions, in violation of Section 4(a) of the Act, 7 U.S.C. § 6(a), or, alternatively, Section 4(b), 7 U.S.C. § 4(b) and Regulation 48.3, 17 C.F.R. § 48.3 (2022);

ii. offering, entering into, confirming the execution of, or transacting in off-exchange transactions in commodity options, in violation of Section 4c(b) of the Act, 7 U.S.C. § 6c(b), and Regulation 32.2, 17 C.F.R. § 32.2 (2022);

iii. soliciting and accepting orders for commodity futures, options, swaps, and retail commodity transactions or acting as a counterparty in any agreement, contract, or transaction described in Section 2(c)(2)(D)(i) of the Act; and, in connection with these activities, accepting money, securities or property (or extending credit in lieu thereof) to margin, guarantee, or secure resulting trades on the Binance platform, in violation of Section 4d of the Act, 7 U.S.C. § 6d;

iv. operating a facility for the trading or processing of swaps without being registered as a swap execution facility ("SEF") or designated as a contract market ("DCM"), in violation of Section 5h(a)(1) of the Act, 7 U.S.C. § 7b-3(1), and Regulation 37.3(a)(1), 17 C.F.R. § 37.3(a)(1) (2022);

v. failing to diligently supervise Binance's activities relating to the conduct that subjects Binance to Commission registration requirements, in violation of Regulation 166.3, 17 C.F.R. § 166.3 (2022);

vi. failing to implement an effective customer information program and to otherwise comply with applicable provisions of the Bank Secrecy Act, in violation of Regulation 42.2, 17 C.F.R. § 42.2 (2022); and

vii. willfully conducting activities outside the United States, including entering into agreements, contracts, and transactions and structuring entities to willfully evade or attempt to evade any provision of the [CEA] as enacted by Subtitle A of the Wall Street Transparency and Accountability Act of 2010, in violation of Regulation 1.6, 17 C.F.R. § 1.6 (2022).

9. Unless restrained and enjoined by this Court, Defendants are likely to continue to engage in the acts and practices alleged in this Complaint and similar acts and practices, as more fully described below.

10. Accordingly, the CFTC brings this action pursuant to Section 6c of the Act, 7 U.S.C. § 13a-l, to enjoin Defendants' unlawful acts and practices and to compel their compliance with the Act. In addition, the CFTC seeks civil monetary penalties and remedial ancillary relief, including, but not limited to, trading and registration bans, disgorgement, pre- and post-judgment interest, and such other relief as the Court may deem necessary and appropriate.

II. JURISDICTION AND VENUE

11. This Court has jurisdiction over this action under 28 U.S.C. § 1331 (federal question jurisdiction) and 28 U.S.C. § 1345 (district courts have original jurisdiction over civil actions commenced by the United States or by any agency expressly authorized to sue by Act of Congress). Section 6c of the CEA, 7 U.S.C. § 13a-1(a), authorizes the CFTC to seek injunctive

relief against any person whenever it shall appear to the CFTC that such person has engaged, is engaging, or is about to engage in any act or practice constituting a violation of any provision of the CEA or any rule, regulation, or order thereunder.

12. Venue properly lies with this Court pursuant to Section 6c(e) of the CEA, 7 U.S.C. § 13a-1(e), because Defendants transacted business in the Northern District of Illinois and Defendants engaged in acts and practices in violation of the CEA and Regulations within this District.

III. PARTIES

A. The CFTC

13. Plaintiff **Commodity Futures Trading Commission** is the independent federal regulatory agency charged by Congress with the administration and enforcement of the Commodity Exchange Act and Regulations promulgated thereunder.

B. Defendants

14. **Changpeng Zhao** is the Chief Executive Officer ("CEO") of Binance. Zhao launched Binance in 2017 from Shanghai, China and has ultimately controlled all of Binance's business activities at all times. Zhao is a Canadian citizen who, based on recent media reports, currently resides in Dubai, United Arab Emirates. Zhao has directly or indirectly owned the scores of entities that collectively operate the Binance platform. In addition to the entities that operate the Binance platform, Zhao is the direct or indirect owner of entities that have engaged in proprietary trading activity on the Binance platform, including Merit Peak Limited and Sigma Chain AG, and Zhao is also the direct or indirect owner of approximately 300 separate Binance accounts that have engaged in proprietary trading activity on the Binance trading platform. Zhao has never been registered with the Commission in any capacity.

15. **Binance Holdings Limited** ("Binance Holdings") is incorporated in the Cayman Islands and directly or indirectly owned by Zhao. Binance Holdings has held intellectual property for Binance, including trademarks and domain names, and has employed at least certain individuals who perform work for or on behalf of the Binance platform. Binance Holdings has never been registered with the Commission in any capacity.

16. **Binance Holdings (IE) Limited** ("Binance IE") is incorporated in Ireland and directly or indirectly owned by Zhao. Binance IE is a holding company that has directly or indirectly owned at least 24 corporate entities that have acted as Binance's digital asset and virtual asset service providers in a variety of jurisdictions and held Binance's non-U.S. regulatory licenses. Binance IE has never been registered with the Commission in any capacity.

17. **Binance (Services) Holdings Limited** ("Binance Services") is incorporated in Ireland and directly or indirectly owned by Zhao. Binance Services is a holding company that has directly or indirectly owned at least 43 different corporate entities, including companies that conduct technology and operations services for Binance, hold the intellectual property related to Binance's matching engines and financial products, and enter into contracts with vendors, as well as a company called Ality Technologies DE LLC that functions as Binance's "U.S. Tech/Ops Hub." Binance Services owns Binance Holdings. Binance Services has never been registered with the Commission in any capacity.

18. **Samuel Lim** was hired in April 2018 as Binance's first Chief Compliance Officer ("CCO") and remained in that role until at least January 2022. On information and belief, Lim resides in Singapore. Binance Holdings refused to provide Lim's residential address in response to a CFTC investigative subpoena. While acting as CCO, Lim advised, directed, and assisted Binance employees and customers in circumventing compliance controls intended to detect and

prevent violations of law. Lim also made representations on behalf of Binance regarding the platform's compliance program and controls to regulators located in the United States. On information and belief, Binance placed Lim on paid, administrative leave in or around May 2022 but continues to employ Lim. Lim has never been registered with the Commission in any capacity.

C. Other Relevant Entities

19. **Binance UAB** is incorporated in Lithuania and directly or indirectly owned by Zhao. Binance UAB is the only entity specifically identified as one of the indeterminate group of "Binance Operators" referenced in Binance's Terms of Use. Binance UAB has never been registered with the Commission in any capacity.

20. **Merit Peak Limited** ("Merit Peak") is incorporated in the Cayman Islands and directly or indirectly owned by Zhao. Merit Peak has primarily engaged in over the counter ("OTC") transactions with institutional counterparties. Merit Peak has never been registered with the Commission in any capacity.

21. **Sigma Chain AG** ("Sigma Chain") is incorporated in Switzerland and directly or indirectly owned by Zhao. It has engaged in proprietary trading in Binance's various markets, including its markets for digital asset derivatives. Sigma Chain has never been registered with the Commission in any capacity.

22. **BAM Trading Services Inc. ("BAM Trading")** is a Delaware company with its principal address in Palo Alto, California. BAM Trading operates Binance.US, a spot digital asset trading platform that offers its services to U.S. residents and relies on Binance's services and technology, obtained through intercompany agreements, to operate. BAM Trading is directly or indirectly majority owned and controlled by Zhao, and Zhao has been a director of

BAM Trading at all relevant times. BAM Trading has never been registered with the Commission in any capacity.

IV. RELEVANT STATUTORY BACKGROUND AND LEGAL FRAMEWORK

A. Applicable Provisions Under the Commodity Exchange Act and Regulations

22. The purpose of the CEA is to "serve the public interests . . . through a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals under the oversight of the Commission," as well as "to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to [the] Act and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation and fair competition among boards of trade, other markets and market participants." Section 3 of the Act, 7 U.S.C. § 5.

23. Derivatives are financial instruments such as futures, options, or swaps that derive their value from something else, including, for example, a benchmark rate, a physical commodity such as oil or wheat, or digital asset commodities. The CEA requires that, subject to certain exemptions, commodity derivative transactions must be conducted on exchanges designated by, or registered with, the CFTC.

24. A digital asset is anything that can be stored and transmitted electronically and has associated ownership or use rights. Digital assets include virtual currencies that are digital representations of value that function as mediums of exchange, units of account, and/or stores of value. Certain digital assets, including BTC, ETH, LTC, and at least two fiat-backed stablecoins, tether ("USDT") and the Binance USD ("BUSD"), as well as other virtual currencies as alleged herein, are "commodities," as defined under Section 1a(9) of the Act, 7 U.S.C. § 1a(9). In recent

years, as digital asset markets have evolved, futures contracts have been offered on certain digital assets by boards of trade that are registered with the CFTC, such as the Chicago Mercantile Exchange and Chicago Board Options Exchange.

25. With limited exceptions, Section 5h(a) of the Act, 7 U.S.C. § 7b-3, and Regulation 37.3, 17 C.F.R. § 37.3 (2022), make it illegal for a person to operate a facility for the trading or processing of swaps unless the facility is registered with the CFTC as a SEF or DCM.

26. Sections 1a(47)(A)(iii), (iv), and (vi) of the Act, 7 U.S.C. §§ 1a(47)(A)(iii), (iv), and (vi), broadly define "swap" to include "any agreement, contract, or transaction"—

> (iii) [T]hat provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interest or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level without also conveying a current or future direct or indirect ownership interest in an asset (including any enterprise or investment pool) or liability that incorporates the financial risk so transferred, including any agreement, contract or transaction commonly known as . . . (I) an interest rate swap; . . . (VII) a currency swap; . . . (XXII) a commodity swap . . . ;
>
> (iv) that is an agreement, contract, or transaction that is, or in the future becomes, commonly known to the trade as a swap; [or]
>
> (vi) that is any combination or permutation of, or option on, any agreement, contract, or transaction described in any of [these clauses].

27. Section 1a(47)(D) of the Act, 7 U.S.C. §§ 1a(47)(D), defines a "mixed swap" as including any "any agreement, contract, or transaction that is described in section 3(a)(68)(A) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(68)(A)) and also is based on the value of 1 or more interest or other rates, currencies, commodities, instruments of indebtedness, indices, quantitative measures, or other financial or economics interest or property of any kind

(other than a single security or a narrow-based security index)." Mixed swaps are jointly regulated by the CFTC and the Securities and Exchange Commission.

28. The provisions of the Act and Regulations that apply to DCMs and SEFs, the facilities where the trading of commodity derivatives typically occurs, establish important protections for U.S. derivatives markets and market participants, including retail customers. For example, DCMs and SEFs must:

(a) conform to core principles that are designed to prevent market abuse, Sections 5(d)(12)(a) and 5h(f)(2)(B) of the Act, 7 U.S.C. §§ 7(d)(12)(a), 7b-3(f)(2)(B);

(b) ensure their financial stability, Sections 5(d)(21) and 5h(f)(13) of the Act, 7 U.S.C. §§ 7(d)(21), 7b-3(f)(13);

(c) protect their information security, Regulations 38.1051(a)(2) and 37.1401(a)(2), 17 C.F.R. §§ 38.1051(a)(2), 37.1401(a)(2) (2022); and

(d) safeguard their systems in the event of a disaster, Sections 5(d)(20) and 5h(f)(14) of the Act, 7 U.S.C. §§ 7(d)(20), 7b-3(f)(14).

29. A futures commission merchant ("FCM") is an individual, association, partnership, corporation, or trust that (i) is engaged in soliciting or in accepting orders for regulated transactions including futures, swaps, commodity options, or retail commodity transactions, or (ii) acts as a counterparty to retail commodity transactions; and which, in connection with either of these activities, "accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom." Section la(28)(A) of the Act, 7 U.S.C. § la(28)(A).

30. Retail commodity transactions are commodity transactions that are entered into with, or offered to persons that are not eligible contract participants "on a leveraged or margined basis, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis." Section 2(c)(2)(D) of the Act, 7 U.S.C. § 2(c)(2)(D).

Subject to certain exceptions, retail commodity transactions are subject to Section 4(a) of the Act, 7 U.S.C. § 6(a), "as if" they are contracts of sale of a commodity for future delivery, and therefore may only be executed on a regulated futures exchange.

31. An eligible contract participant ("ECP") is, in general, an individual who has amounts invested on a discretionary basis, the aggregate of which is in excess of $10 million, or $5 million if the individual enters into the transaction "in order to manage the risk associated with an asset owned or liability incurred, or reasonably likely to be owned or incurred, by the individual." Section 1a(18)(xi) of the Act, 7 U.S.C. § 1a(18)(xi).

32. Among other things, FCMs hold customer funds to margin commodity derivative transactions. In this intermediary role, FCMs are thus a critical component of the U.S. financial system and must comply with requirements, including customer protection and financial integrity requirements, imposed by the Act and Regulations. Among the most fundamental of these requirements is that any person that acts as an FCM shall register as such with the Commission. Section 4d(a) of the Act, 7 U.S.C. § 6d(a). In addition to registration, FCMs must establish safeguards to prevent conflicts of interest, Section 4d(c) of the Act, 7 U.S.C. § 6d(c); segregate customer assets to protect them from the risk of the FCM's insolvency, 7 U.S.C. § 6d(a)(2); and employ only salespeople who register with the CFTC and meet strict proficiency requirements, Section 4k(1) of the Act, 7 U.S.C. § 6k(1).

33. Regulation 166.3, 17 C.F.R. § 166.3 (2022), requires a Commission registrant such as an FCM to diligently supervise all activities of its officers, employees, and agents relating to its business as a Commission registrant. The term "Commission registrant" as used in 17 C.F.R. § 166.3 means "any person who is registered or required to be registered with the

Commission pursuant to the Act or any rule, regulation, or order thereunder." Regulation 166.1(a), 17 C.F.R. § 166.1(a).

34. Regulation 42.2, 17 C.F.R. § 42.2 (2022), requires, among other things, that every FCM shall comply with applicable provisions of the Bank Secrecy Act ("BSA") and the regulations promulgated by the Department of the Treasury under that Act at 31 C.F.R. chapter X, and with the requirements of 31 U.S.C. § 5318(l) and the implementing regulation jointly promulgated by the Commission and the Department of the Treasury at 31 C.F.R. § 1026.220, which require that an FCM adopt a customer identification program ("CIP") and file reports with the Financial Crimes Enforcement Network ("FinCEN") concerning certain specified activities and transactions as components of its BSA compliance program.

35. The regulations promulgated by the Department of Treasury under 31 C.F.R. chapter X require, as relevant here, that every FCM must: (1) implement a written CIP that, at a minimum, includes procedures for verifying the identity of each customer sufficient to enable the FCM to form a reasonable belief that it knows the true identity of each customer; (2) retain records collected pursuant to the CIP; and (3) implement procedures for determining whether a customer appears on any list of known or suspected terrorists or terrorist organizations.

B. Provisions Authorizing Imposition of Derivative Liability Under the CEA

36. Section 2(a)(1)(B) of the Act, 7 U.S.C. § 2(a)(1)(B), and Regulation 1.2, 17 C.F.R. § 1.2 (2022), provide that the "act, omission, or failure of any official, agent, or other person acting for any . . . corporation . . . within the scope of his employment or office, shall be deemed the act, omission, or failure of such . . . corporation . . . as well as such official, agent, or other person."

37. Section 13(a) of the Act, 7 U.S.C. § 13c(a), provides: "Any person who commits, or who willfully aids, abets, counsels, commands, induces or procures the commission of, a

violation of any of the provisions of this Act, or any of the regulations or orders issued pursuant to this Act, or who acts in combination or concert with any person in such violation, or who willfully causes an act to be done or omitted which if directly performed or omitted by him or another would be a violation of the provisions of this Act or any of the rules, regulations, or orders may be held responsible for such violation as a principal."

38. Section 13(b) of the Act, 7 U.S.C. § 13c(b), provides that any "person who, directly or indirectly, controls any person who has violated the Act, or regulations promulgated thereunder, may be held liable for such violations to the same extent as the controlled person if the controlling person did not act in good faith or knowingly induced, directly or indirectly, the acts constituting the violation."

C. Anti-Evasion Principles in the CEA and Regulations

39. Regulation 1.6(a), 17 C.F.R. § 1.6(a) (2022), provides that it "shall be unlawful to conduct activities outside the United States, including entering into agreements, contracts, and transactions and structuring entities, to willfully evade or attempt to evade any provision of the Commodity Exchange Act as enacted by Subtitle A of the Wall Street Transparency and Accountability Act of 2010 or the rules, regulations, and orders of the Commission promulgated thereunder." *See also* Section 2(i)(2) of the Act, 7 U.S.C. § 2(i)(2) (authorizing promulgation of anti-evasion regulations).

V. FACTS

A. Overview of the Binance Platform and Operations

40. Binance is a centralized, web-based "crypto-products platform" that has offered trading in digital asset commodities and related derivatives, among other financial products and services, to over 100 million customers throughout the world, including in the United States. Binance holds itself out as the world's "largest crypto exchange by trade volume" and is reported

to have amassed over half the global market share for digital asset exchange activity as of the end of 2022.

41. Beginning with its launch in July 2017, Binance has offered customers transactions in digital asset spot markets. In July 2019, Binance began offering its customers leverage with which to trade in its digital asset spot markets. According to Binance, its two most heavily traded digital assets in its spot markets are BTC and ETH. In September 2019, Binance began offering digital asset derivative products. Binance's most heavily traded derivative products incorporate BTC or ETH as underlying assets.

42. Although Binance now offers numerous financial products, its core offering is to act as a centralized trading platform at which market participants (i.e. customers) may transact in digital assets or digital asset derivatives by transmitting orders to buy or sell into what Binance calls order books. Binance's order book-based markets execute transactions based generally on price-time priority pursuant to non-discretionary order matching methodology.

43. Customers may also purchase and trade digital assets on Binance through other trading protocols, including bilateral transactions (also called "OTC") in which Binance acts as one counterparty to the trade. Binance customers can also acquire digital assets directly from Binance through Binance's "Buy Crypto" functionality.

44. Binance customers may place orders through the user interface available at www.binance.com, through the Binance mobile application, and by direct connection to Binance's matching engines via the Binance application programming interface ("API"). API connections are generally used by more technologically sophisticated customers, such as proprietary trading firms or other institutional market participants.

45. Among other sources of revenue, Binance makes money by charging its customers transaction fees for trades made on its platform. Transaction fees vary based on the product and the customer's trading volume, and are Binance's largest source of revenue. In a December 2022 interview, Zhao estimated that transaction revenue accounts for approximately 90 percent of Binance's revenue. A meaningful percentage of that revenue has been and continues to be derived from digital asset derivative transactions entered into by U.S. customers, including customers in this District.

46. Binance launched its own digital asset called the Binance Coin (BNB) through an initial coin offering in 2017. Customers can trade BNB like any other digital asset on Binance and Binance incentivizes its users to purchase, use, and hold BNB tokens. For example, Binance customers that elect to pay their trading fees using BNB receive a discount for doing so. BNB holdings are one criterion for customers to gain VIP status, which as described below confers benefits on the customer including lower transaction fees.

47. Since approximately September 2019, Binance has offered BUSD, a proprietary stablecoin. At least prior to February 21, 2023, it did so through a contract with Paxos Trust Company LLC ("Paxos"), a New York trust company. Binance has represented that BUSD is "compliant with [] strict regulatory standards."

48. Binance refers to its important customers as VIPs. Binance's VIP customers are often institutional market participants. VIP customers are important to Binance because they provide liquidity to Binance's markets and pay Binance a lot of fees. Binance is aware of its VIPs' identities and geographic locations because Binance monitors its sources of transaction volume and fee-based revenue as a matter of course in conducting its operations.

49. Binance's VIP program rewards important customers by providing reduced rates for transaction fees and white-glove customer service, as well as exceptions to Binance's trading rules including order messaging limits. Higher status VIPs also receive preferential access to Binance's matching engines, among other benefits. Binance categorizes its VIPs into levels one to nine, with VIP 9 being the highest level occupied by the most important Binance customers. A customer's VIP level is determined by, among other things, their 30-day trading volume and BNB holdings. For example, in December 2021, a customer could maintain a VIP 9 level by engaging in "futures trading" volume of 25,000,000,000 (as measured by BUSD) and maintaining a 5,500 BNB balance over a 30-day period.

50. Binance has relied on a dedicated team of employees and other agents to provide personalized service to its VIP customers. These personnel have been known by various labels including the VIP team, Key Account Managers, and institutional sales representatives.

51. Another important benefit that Binance has provided its VIP customers is prompt notification of any law enforcement inquiry concerning their account. According to a policy titled "For management of LE requests for information and funds transfer," created by Lim based on directions from Zhao, Binance instructed its VIP team to notify a customer

> [A]t point of [account] freeze [based on a request from a law enforcement agency] and immediately after the unfreeze [which would occur 24 hours after the account freeze]. VIP team is to contact the user through all available means (text, phone) to inform him/her that his account has been frozen or unfrozen. Do not directly tell the user to run, just tell them their account has been unfrozen and it was investigated by XXX. If the user is a big trader, or a smart one, he/she will get the hint.

52. Binance officers, employees, and agents have used numerous messaging applications for business communications during the Relevant Period. In addition to email and

internal messaging applications, Binance's personnel have also used at least Telegram, WeChat, and Signal to communicate internally and with Binance customers.

53. The Signal messaging application allows a user to enable an auto-delete functionality to cover their tracks after communicating about inculpatory matters. Zhao and others acting on behalf of Binance have used Signal—with its auto-delete functionality enabled—to engage in business communications, even after Binance received document requests from the CFTC and after Binance purportedly distributed document preservation notices to its personnel.

54. Zhao has communicated over Signal with the auto-delete functionality enabled with numerous Binance officers, employees, and agents for widely varying purposes. For example, the following Signal text chains or group chats collected from Zhao's telephone were among those set to auto-delete:

a. a group chat between Zhao, Binance's then-head of institutional sales, and Binance's head of "Big Data," which is the operational group responsible for creating and maintaining Binance's data and databases including the database that contains customer- and transaction-related information;

b. a text chain with a senior member of Binance's VIP team;

c. a text chain with a compliance consultant who participated in the creation of the strategy concerning the launch of Binance.US and Binance's attendant efforts to retain U.S. customers;

d. a text chain with an accounting employee who participated in the preparation of Binance's monthly revenue reports for Zhao;

e. text chains with senior operations personnel; and

f. group chats titled "Finance," "HR," "Mkt hr," and "CEO office."

55. Zhao has also instructed Binance officers, employees, and agents to use Signal to communicate with U.S. customers. On information and belief, Binance does not have a corporate communications policy and continues to use Signal for business communications.

B. Relevant Financial Products Offered by Binance

56. Beginning in July 2019, Binance has offered leverage to retail customers (that is, non-ECPs) trading in its spot markets, which generally include its markets for BTC, ETH, and other digital assets. These leveraged transactions do not result in actual delivery of the digital asset within 28 days of the transaction. According to Binance, "leverage refers to using borrowed capital to make trades. Leverage trading can amplify your buying or selling power, allowing [the customer] to trade larger [notional] amounts." Zhao approved Binance's retail leverage trading products before they were launched.

57. When a retail customer trades in Binance's spot markets using leverage, Binance extends the customer a loan that is denominated in a digital asset that is selected by the customer. The customer may then use the loan proceeds to transact in Binance's spot markets. Until the loan is paid back by the customer, Binance retains a security interest in the loan proceeds and in any assets purchased with the loan proceeds, up to the value of the loan.

58. Beginning in April 2020, Binance has offered a product called "Binance Options." According to Binance, Binance Options are a financial derivative that "give traders the right but not the obligation to buy or sell the underlying asset" upon the expiration of the options contract. The underlying assets for Binance Options include BTC, ETH, and BNB. Binance Options are denominated and settled in USDT, not the option's underlying digital asset.

59. At times during the Relevant Period, Binance has been the sole seller of Binance Options. An options seller is one counterparty to an options transaction, so when Binance sells options it is trading against its customers.

60. During the Relevant Period, Binance has also offered two categories of digital asset derivatives that it calls "futures"—one category, called quarterly futures, is composed of contracts that have pre-determined expiration dates while the other category, perpetual contracts,

is composed of contracts that do not have an expiration date. These products all derive their value from the price of the underlying digital asset.

61. Binance began offering quarterly futures in or around September 2019. Binance's quarterly futures are futures contracts. Binance customers trade quarterly futures with numerous digital assets as the base asset (what would in traditional financial markets be called the underlier), including BTC, ETH, and LTC. Binance's quarterly futures are settled in whatever digital asset the customer uses to collateralize their trading.

62. Following in the footsteps of its competitors, since at least September 2019 Binance has offered a product that Binance calls perpetuals contracts, sometimes called simply "perpetuals" by Binance's customers. Binance's perpetuals are swaps. Binance's perpetuals transfer the price risk of the underlying digital asset as between the counterparties to a transaction. Binance's perpetuals do not have a pre-determined expiration date; a trader closes a position in perpetual contracts by entering into an offsetting transaction, at which time the trade settles in whatever digital asset the customer uses to collateralize their trading. Binance offers perpetuals on numerous digital assets, including contracts with BTC, ETH, and LTC as the base asset. Its most popular perpetuals include BTC/USDT, ETH/USDT and BTC/BUSD.

63. Every eight hours, Binance causes the counterparties to a transaction in its perpetuals to exchange a payment that Binance calls a "funding fee." In the context of Binance's perpetuals, the funding fee is intended to ensure the price of the perpetual contract stays sufficiently correlated to the price of the underlying digital asset as reflected by a price index that is determined by Binance and calculated based on prices reported by other digital asset exchanges.

64. Transactions in Binance's quarterly futures and perpetual contracts do not result in an exchange of the underlying digital asset between the counterparties to a trade. As explained by Binance: "Crypto futures are contracts that represent the value of a specific cryptocurrency. You do not own the underlying cryptocurrency when you purchase a futures contract. Instead, you own a contract under which you have agreed to buy or sell a specific cryptocurrency at a later date." In this way, a derivatives trade on Binance is more like placing a bet on the price of a digital asset, rather than a way to purchase digital assets themselves.

65. Customers have had the option to collateralize their trading in Binance's quarterly futures and perpetual contracts with either certain stablecoins, including USDT or BUSD, or certain non-stablecoin digital assets, including BTC.

66. Binance customers may trade quarterly futures and perpetual contracts on margin, or with leverage. The amount of leverage offered by Binance for trading in its quarterly futures and perpetual contracts has varied over time across its products and categories of customers. During the Relevant Period, customers have been allowed to trade Binance's quarterly futures and perpetual contracts with leverage ratios of up to 125x. A leverage ratio of 125x means a customer with one BTC in their account can assume a position worth 125 BTC. Unlike the leverage that Binance offers in connection with its spot markets, Binance does not actually extend its customers a loan when providing leverage to trade in Binance's derivatives markets.

67. Zhao has been directly involved in Binance's product offerings. He has monitored the derivative products offered by competing digital asset exchanges and brainstormed ways for Binance to keep pace with its competition. For example, in an October 28, 2020 chat among the Binance Market Intelligence Group, Zhao circulated a web link

referencing "gamified-crypto-trading" and told an employee to "keep an eye on this." The employee responded:

> We have done some research on this . . . . Right now most of the gamification trading are based on some complex derivative financial instruments, such as binary options, exotic options or perpetual swaps. The reason why we did the Futures Battle is we wanted to lower the barrier of complex financial products and increase the conversion/retention rate. But there is [sic] 2 things we need to be very careful:
> 1. Usually this kind of products looks like gambling, which may bring us some compliance and reputation risk. So we need to make sure the product does not look like a gamble game.
> 2. User might be much easier to get addicted to these products. So we need to enhance responsible trading (or you could say playing) as well

Binance currently offers a "Battle function" that "allows users to compete with each other and earn points" by trading Binance derivative contracts in a "head to head battle to see who is the most profitable" in "a one-minute battle period."

68. In an August 2020 blog post announcing the launch of BTC-margined perpetuals (in addition to USDT-margined perpetuals, which had been offered since September 2019) at up to 125x leverage, Binance touted the success of its perpetual contracts. Binance stated that its "perpetual futures consistently owns the largest trading volume, with recent monthly market share averaging 37%." In that same blog post, Binance highlighted its "competitive leverage of up to 125x" and Zhao lauded that "shortly after hitting an all-time-high of $13 billion in daily futures volume last month, we crossed the $1 billion mark in open interest last week."

C. Binance's Proprietary Trading Activity on Binance

69. During the Relevant Period, Binance has traded on its own platform through approximately 300 "house accounts" that are all directly or indirectly owned by Zhao, as well as accounts owned by Merit Peak and Sigma Chain. Zhao has also traded on the Binance platform through two individual accounts. At various times during the Relevant Period, Merit Peak has entered into OTC transactions with Binance customers (and settled such trades by depositing

digital assets directly into its counterparties' Binance accounts), while Sigma Chain has engaged in proprietary trading in Binance's various markets, including its markets for digital asset derivatives. On information and belief, Binance's proprietary trading activity on Binance's own markets is directed by Binance's "quant desk."

70. Binance does not disclose to its customers that Binance is trading in its own markets in its Terms of Use or elsewhere. Consistent with its apparent attempt to keep its proprietary trading activity on its own markets top secret, Binance has refused to respond to Commission-issued investigative subpoenas seeking information concerning its proprietary trading activity on Binance, including transaction data and communications among the members of the Binance "quant desk."

71. On information and belief, Binance has not subjected the trading activity of Merit Peak, Sigma Chain, or its approximately 300 house accounts to any anti-fraud or anti-manipulation surveillance or controls and to the extent Binance purports to have required its officers, employees, and agents to abide by a relatively new "insider trading" policy, Binance's approximately 300 house accounts are exempt from that policy.

D. Binance's Presence in the United States

72. Throughout the Relevant Period, Binance has maintained significant ties to the U.S. financial system and economy and has actively solicited customers in the United States through its marketing efforts including on numerous social media applications such as Twitter.

73. Binance has employed at least 60 people in the United States, and that number continues to increase. Among Binance's U.S.-based employees are compliance and investigations personnel; personnel involved with Binance's private equity arm, known as "Binance Labs"; a key employee who managed the business unit that was responsible for

"Binance's official crypto wallet," a product Binance has offered called "Trust Wallet"; in-house lawyers; and Binance's current "Chief Strategy Officer."

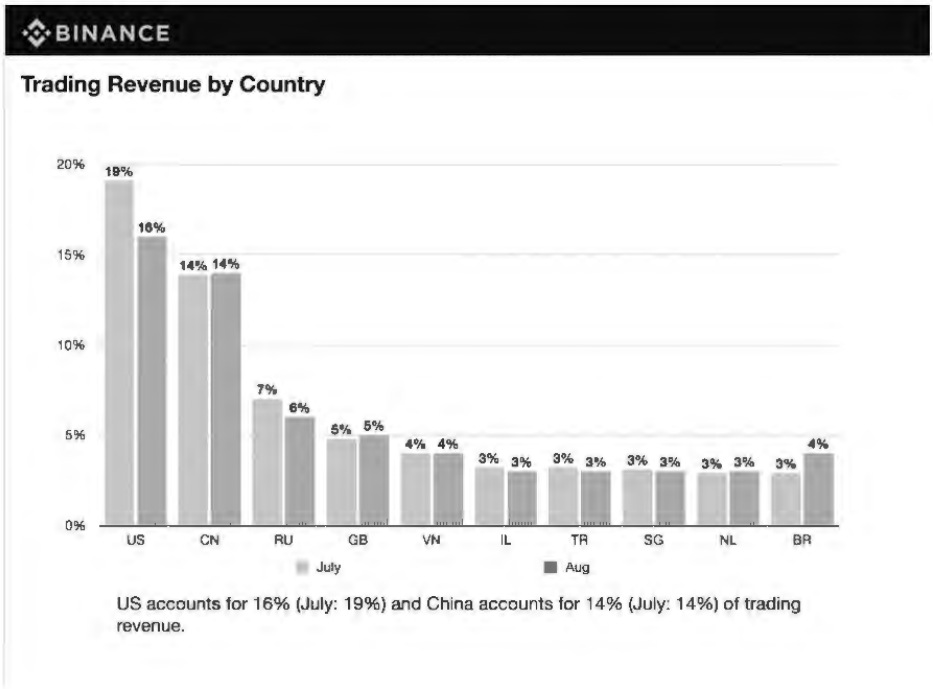
74. During the Relevant Period, Binance has enlisted U.S. residents to act as "Binance Angels" to solicit and interact with U.S. customers. Generally, Binance Angels attempt to recruit new customers to Binance, answer questions from customers and prospective customers, and test new Binance features. In return, Binance Angels receive benefits such as invitations to events and Binance swag.

75. From Binance's early days, Zhao has known that U.S. customers trade on the platform. Zhao has personally interacted with Binance's U.S. customers. For example, in 2017, and in connection with Binance's early phase of targeting U.S. customers, Zhao provided instructions to a U.S. resident with respect to an English-language customer support channel over the Telegram messaging application. Later, on January 8, 2018, a U.S. trading firm emailed Zhao directly to onboard to Binance, identified the owner of the company as a U.S. citizen, and provided the company's owner's U.S. passport and Illinois driver's license to Zhao.

76. Zhao, Lim, and other Binance senior management have known that U.S. customers trade on Binance and have tracked and monitored their activities for multiple purposes. For example, Zhao has received periodic reports concerning the nature and geographic location of Binance's customers as well as the sources of Binance's revenue. These reports contain information about Binance's U.S. customers and the effectiveness of Binance's efforts to capture the U.S. market.

77. An example of a periodic report that contains information about Binance's sources of revenue is titled August [2019] Financial Reporting Package. The August Financial Reporting Package breaks downs Binance's trading revenue by base asset (with BTC-related

transactions comprising 44% of Binance's revenue for that month), and trading volume, among other metrics. One slide on the August Financial Reporting Package is titled "Trading Revenue by Country" and displays Binance's focus on the geographic sources of its revenue, including the 16% for that month (and 19% for July 2019) that Binance attributed to customers located in the "US" as shown here:



78. Binance officers, employees, and agents have interacted with U.S.-based institutional customers at Binance-hosted networking and social events in the United States at various times during the Relevant Period, including an April 2022 party in Las Vegas to which Binance invited its "largest accounts" such as "top heavy weights of hfts, prime brokerage, [and] vcs," and a networking event in Austin, Texas. Binance and Zhao have also participated in numerous digital asset industry conferences in the United States.

79. During the Relevant Period, Binance has procured professional services from U.S.-based law firms, compliance consultants, and other vendors concerning various aspects of its business operations. For example, Binance relies on the Google suite of products for

information management and email services. Binance uses Webex for its internal messaging functionality. Binance leases office space from WeWork that it makes available to its U.S.-based employees and other personnel. Binance has entered into long term contracts with Amazon Web Services, a United States company headquartered in Washington. Among the services Binance purchases from Amazon Web Services that are provided to Binance in the United States is "AWS CloudFront," which according to Amazon Web Services is a "Global content delivery network." Zhao has paid for certain of Binance's Amazon Web Services accounts using his personal credit card.

80. Binance avails itself of the U.S. legal system to seek protection for its intellectual property. For example, Binance Holdings filed trademark applications for "Binance"; "Binance Chain"; and "Binance DEX" with the assistance of U.S. attorneys. These U.S. trademarks remain active.

81. In 2019, Zhao and BAM Trading launched Binance.US, a digital asset spot market trading platform that offers its services to U.S. customers. When he hired BAM Trading's first CEO, Zhao described Binance as a pirate ship and explained that he wished for Binance.US to be a navy boat. BAM Trading is under common ownership and control with Binance and continues to operate the Binance.US spot platform. Binance personnel, including Zhao, have dictated Binance.US's corporate strategy, launch, and early operations. At Zhao's direction, Binance.US's marketing and branding has mirrored that of Binance.com. BAM Trading has licensed Binance's trademarks to advertise in the United States. Binance.US has also relied on one of Binance's matching engines through a software licensing agreement.

E. Zhao Controls Binance and Operates Binance as a Common Enterprise

82. Throughout the Relevant Period, Zhao has directly or indirectly owned and controlled all of the corporate entities, including Binance Holdings, Binance IE, Binance

Services and dozens of other corporate vehicles included in the Binance ecosystem that operate the Binance platform together as a common enterprise. Binance's corporate organizational chart includes over 120 entities incorporated in numerous jurisdictions around the world. At times, at least certain of those entities, including Binance Holdings, Binance IE, and Binance Services have commingled funds, relied on shared technical infrastructure, and engaged in activities to collectively advertise and promote the Binance brand.

83. Binance's reliance on a maze of corporate entities to operate the Binance platform is deliberate; it is designed to obscure the ownership, control, and location of the Binance platform. Consistent with this design, Binance's enigmatic Terms of Use define "Binance" as "an ecosystem comprising Binance websites (whose domain names include but are not limited to https://www.binance.com/en), mobile applications, clients, applets and other applications that are developed to offer Binance Services, and includes independently-operated platforms, websites and clients within the ecosystem" and the "Binance Operators" to include "all parties that run Binance, including but not limited to legal persons (including Binance UAB), unincorporated organizations and teams that provide Binance Services and are responsible for such services." The Terms of Use also state that Binance Operators and Binance are the same thing and the composition of the Binance Operators may change at any time.

84. Binance is so effective at obfuscating its location and the identities of its operating companies that it has even confused its own Chief Strategy Officer. For example, in September 2022 he was quoted as saying that "Binance is a Canadian company." The Chief Strategy Officer's statement was quickly corrected by a Binance spokesperson, who clarified that Binance is an "international company."

85. As founder and CEO of Binance, Zhao has been responsible for all major strategic decisions, business development, and management of the Binance enterprise. Zhao also involves himself in the minutiae of Binance's operations. For example, Zhao personally approved an approximately $60 expense related to office furniture in January 2021, a month in which Binance earned over $700 million in revenue.

86. Zhao has been responsible for directing and overseeing the creation and operation of Binance's trade matching engines, website, API functionalities, and order entry system. Zhao is also the public face of Binance; he represents Binance in public speaking engagements and appearances, gives interviews to magazines and other news media, and frequently authors Tweets and blog posts related to Binance business.

87. Over time, Zhao hired a senior management team that included Lim. However, Zhao has been involved in and ultimately retained control over all critical decisions for the enterprise, including which products to offer and whether and how to implement and enforce anti-money laundering ("AML") controls and Know Your Customer ("KYC") procedures. Zhao is ultimately responsible for evaluating the legal and regulatory risks associated with Binance's business activities, including those related to the launch of Binance.US, and has been directly involved in discussions with compliance consultants and lawyers concerning legal and regulatory issues implicated by Binance's business activities.

88. Zhao answers to no one but himself. Binance does not have a board of directors.

F. Binance's Superficial Efforts to Limit Trading by United States Customers and Internal Recognition That Its Compliance Program Was Just "For Show"

89. Throughout the Relevant Period, Binance purposefully grew, maintained, and simultaneously concealed its U.S. customer base while also failing to implement an effective AML program that is required of financial institutions such as FCMs to detect and prevent

terrorist financing or other criminal activity, among other things. One component of this failure to implement an effective AML program is Binance's ongoing lack of effective KYC procedures or a CIP that would enable it to determine the true identity of its customers, whether from the United States or elsewhere. Further, as of at least May 2022, Binance had not filed a single suspicious activity report ("SAR") in the United States despite having filed such reports in other jurisdictions.

90. For approximately the first two years of its operations, Binance did not take any steps to limit or restrict the ability of U.S. customers to trade on the platform.

91. Even after Binance began to purportedly restrict access to its platform from certain jurisdictions in mid-2019, it left open a loophole for customers to sign up, deposit assets, trade, and make withdrawals without submitting to any KYC procedures as long as the customer withdrew less than the value of two BTC in one day. Binance has referred to this two BTC-no KYC loophole by various labels, including "email registration," and "tier 1" customers. The two BTC withdrawal limit was effectively meaningless—the notional value of two BTC in July 2019 was more than $22,000 and in March 2021 was more than $100,000.

92. Even before Binance made any attempts to restrict access to the platform by U.S. customers, Lim privately explained to Zhao that the two BTC-no KYC loophole would continue to allow U.S. customers to access the platform. In February 2019, Lim chatted to Zhao: "a huge number" of Binance's "TIER 1 [meaning customers trading via the two BTC-no KYC loophole] could be U.S. citizens in reality. They have to get smarter and VPN through non-U.S. IP." And Zhao stated during a management meeting in June 2019 that the "under 2 BTC users is [sic] a very large portion of our volume, so we don't want to lose that," although he also understood

that due to "very clear precedents," Binance's policy of allowing "those two BTCs without KYC, this is definitely not possible in the United States."

93. In June 2019, around the same time Binance announced a "partnership" with BAM Trading to launch what would become the Binance.US platform, Binance updated its Terms of Use to state for the first time that "Binance is unable to provide services to any U.S. person." Binance also announced that "[a]fter 90 days, effective on 2019/09/12, users who are not in accordance with Binance's Terms of Use will continue to have access to their wallets and funds, but will no longer be able to trade or deposit on Binance.com."

94. In September 2019, Binance claimed it had begun to block customers based on their internet protocol ("IP") address. In reality, Binance simply added a pop-up window on its website that appeared when customers attempted to log in from an IP address associated with the United States. The pop-up did not block customers from logging in to their account, depositing assets, or trading on the platform, it just asked them to self-certify that they were not a U.S. person before accessing the platform by clicking a button on the pop-up.

95. Notwithstanding the pop-up compliance control, Binance knew that U.S. customers continued to comprise a substantial proportion of Binance's customer base even after September 2019 because, among other reasons, Binance's internal reporting told them so. According to periodic revenue reports prepared for and sent to Zhao every month, as of January 2020 approximately 19.9% of Binance's customers were located in the United States, and as of June 2020—about a year after Binance amended its Terms of Use as alleged above in paragraph 93—approximately 17.8% of Binance's customers were located in the United States.

96. In keeping with Binance and Zhao's ethos of prioritizing profits over legal compliance, they knowingly allowed the two BTC-no KYC loophole to persist. In an October 2020 chat between Lim and a Binance colleague, Lim explained:

> [Because you attended a telephone conference on which Zhao participated] then you will also know that as a company, we are probably not going to remove no kyc (email registration) because its too painful . . . i think cz understands that there is risk in doing so, but I believe this is something which concerns our firm and its survivability. If Binance forces mandatory KYC, then [competing digital asset exchanges] will be VERY VERY happy.

97. Binance senior management, including Zhao, continued to be aware of and discuss the two BTC-no KYC loophole. For example, in a March 2021 Signal message group that included multiple senior managers, Zhao asked: "Who was in the 2BTC limit meeting last time?"

98. And on August 20, 2021, Binance announced that "all Binance users are required to verify their accounts," meaning that all new customers would be required to complete "Intermediate Verification" and provide a government issued identification evidencing their geographic location. Binance also announced that existing customers that had not yet completed Intermediate Verification would have their account changed to "withdrawal only" status by October 19, 2021. Binance did not limit the ability of unverified customers to deposit funds and trade on the platform by October 19, 2021 as represented. In February 2022, Binance testified that the identities of approximately only 30–40% of its customers had been verified though KYC documentation.

99. Binance has been aware that its compliance controls have been ineffective. As Lim—at the time Binance's CCO—recognized in an October 2020 chat with other Binance compliance personnel, Binance's compliance environment has amounted to "email sending and no action . . . for media pickup . . . I guess you can say its 'fo sho.'"

100. Zhao's strategy of refusing to implement effective compliance controls at Binance was widely known within Binance. In a January 2019 chat between Lim and a senior member of the compliance team discussing their plan to "clean up" the presence of U.S. customers on Binance, Lim explained: "Cz doesn't wanna do us kyc on .com." And Lim acknowledged in February 2020 that Binance had a financial incentive to avoid subjecting customers to meaningful KYC procedures, as Zhao believed that if Binance's compliance controls were "too stringent" then "[n]o users will come."

101. Despite their awareness of Binance's compliance failures, Zhao, Lim, and others acting on behalf of Binance publicly represented that the platform had effective compliance controls. For example, in an August 14, 2019 letter sent on Binance letterhead, Lim assured a state financial regulator in the United States that

> [O]ur [compliance] program provides for AML/CFT controls to ensure the safe and legitimate use of our platforms . . . . Binance screens all its customers prior to the establishment of a business relations or undertaking a transaction against OFAC, EU, UK and Hong Kong sanctions . . . . Binance performs customer due diligence (CDD) anytime the company establishes a customer relationship with all customers engaged in crypto-fiat activity, where there is suspicion of money laundering or terrorism financing . . . .

102. Four months later, in an internal December 2019 message to a colleague, Lim admitted that ".com doesn't even do AML namescreening/sanctions screening."

103. Binance also intentionally tried to hide the scope of its compliance program's ineffectiveness from its business partners. For example, in or around October 2020, Binance underwent a compliance audit to satisfy a request from Paxos. But according to Lim, Binance purposely engaged a compliance auditor that would "just do a half assed individual sub audit on geo[fencing]" to "buy us more time." As part of this audit, the Binance employee who held the title of Money Laundering Reporting Officer ("MLRO") lamented that she "need[ed] to write a

fake annual MLRO report to Binance board of directors wtf." Lim, who was aware that Binance did not have a board of directors, nevertheless assured her, "yea its fine I can get mgmt. to sign" off on the fake report. Around the same time as the referenced "half assed" compliance audit, in November 2020 the MLRO exclaimed to Lim in a chat, "I HAZ NO CONFIDENCE IN OUR GEOFENCING."

104. Internally, Binance officers, employees, and agents have acknowledged that the Binance platform has facilitated potentially illegal activities. For example, in February 2019, after receiving information "regarding HAMAS transactions" on Binance, Lim explained to a colleague that terrorists usually send "small sums" as "large sums constitute money laundering." Lim's colleague replied: "can barely buy an AK47 with 600 bucks." And with regard to certain Binance customers, including customers from Russia, Lim acknowledged in a February 2020 chat: "Like come on. They are here for crime." Binance's MLRO agreed that "we see the bad, but we close 2 eyes."

105. Lim's internal discussions with compliance colleagues illustrate that Binance has tolerated Binance customers' use of the platform to facilitate "illicit activity." For example, in July 2020, a Binance employee wrote to Lim and another colleague asking if a customer whose recent transactions "were very closely associated with illicit activity" and "over 5m USD worth of his transactions were indirectly sourced from questionable services" should be off-boarded or if it was in the class of cases "where we would want to advise the user that they can make a new account." Lim chatted in response:

> Can let him know to be careful with his flow of funds, especially from darknet like hydra
>
> He can come back with a new account
> But this current one has to go, it's tainted

106. Lim's instruction to allow a customer "very closely associated with illicit activity" to open a new account and continue trading on the platform is consistent with Zhao's business strategy, which has counseled against off-boarding customers even if they presented regulatory risk. For example, in a September 2020 chat Lim explained to Binance employees that they

> Don't need to be so strict.
> Offboarding = bad in cz's eyes.

107. Binance's corporate communications strategy has attempted to publicly portray that Binance has not targeted the United States at the same time Binance executives acknowledge behind closed doors that the opposite is true. For example, on June 9, 2019, around the time Zhao and Binance hatched their secret plot to retain U.S. customers even after the launch of Binance.US, Binance's Chief Financial Officer stated during a meeting with senior management including Zhao:

> [S]ort of, the messaging, I think would develop it as we go along is rather than saying we're blocking the US, is that we're preparing to launch Binance US. So, we would never admit it publicly or privately anywhere that we serve US customers in the first place because we don't. So, it just so happens we have a website and people sign up and we have no control over [access by U.S. customers] . . . . [B]ut we will never admit that we openly serve US clients. That's why the PR messaging piece is very, very critical

Zhao agreed that Binance's "PR messaging" was critical, explaining in a meeting the next day that "we need to, we need to finesse the message a little bit . . . . And the message is never about Binance blocking US users, because our public stance is we never had any US users. So, we never targeted the US. We never had US users." But during the June 9, 2019 meeting, Zhao himself stated that "20% to 30% of our traffic comes from the US," and Binance's "July [2019 Financial] Reporting Package," which was emailed directly to Zhao, attributes approximately 22% of Binance's revenue for June 2019 to U.S. customers.

G. Binance Was Aware of United States Regulatory Requirements but Ignored Them

108. Defendants have been aware of the regulatory regime that applies to U.S. financial institutions such as FCMs, and exchanges such as DCMs and SEFs, throughout the Relevant Period, but have made deliberate, strategic decisions to evade federal law.

109. Internal messages among Zhao, Lim, and other Binance senior managers document that Binance was aware of the applicability of U.S. regulatory and legal requirements since its early days. For example, in October 2018, and before the Relevant Period, Lim wrote to Zhao:

> Cz I know it's a pain in the ass but its my duty to constantly remind you
> 1. We have made no mention of sanctions/or support of sanctions on our platform already (done, cleaned up)
> 2. Are we going to proceed to block sanction countries ip addresses (we currently have users from sanction countries on .com)
>
> Or do you want to adopt a clearer strategy after we engaged and finalised our USA strategy?
> Downside risk is if fincen or ofac has concrete evidence we have sanction users, they might try to investigate or blow it up big on worldstage

110. Two months later, in a December 2018 chat, Lim acknowledged that Binance was operating "in the USA" and advised his colleagues that "there is no fking way in hell I am signing off as the cco for the ofac shit." In that same chat, Lim recognized that Binance's customer support was "teaching ppl how to circumvent sanctions." And Lim stated in an October 2019 chat: "the ofac regulation clearly states U.S. persons, doing biz with OFAC is wrong," but clarified that Zhao desired to place competitive advantage over compliance: "thing is [Zhao] will only agree to block US on .com once US exchange has gotten all [money transmitter licenses] (to match [a U.S.-based digital asset exchange])."

111. In December 2019, approximately three months after Binance began offering quarterly futures and perpetual contracts, Lim wrote to a colleague in a chat:

> 1. We still have US users on our platform (regulatory risk) 2. We do not perform Worldcheck on .com (sanctions risk) 3. We do not perform [transaction monitoring] on .com (sanctions risk).

112. Lim has displayed a nuanced understanding of applicable regulatory requirements and the potential individual liability that may accompany a failure to comply with U.S. law. For example, in October 2020 Lim chatted to a colleague:

> US users = CFTC = civil case can pay fine and settle
> no kyc = BSA act [sic] = criminal case have to go [to] jail

113. Zhao has also been keenly aware of U.S. laws that apply to Binance's activities. For example, Zhao explained during a June 9, 2019 management meeting:

> [T]here are a bunch of laws in the US that prevent Americans from having any kind of transaction with any terrorist, and then in order to achieve that, if you serve US or US sanctioned countries there are about 28 sanctioned countries in the US you would need to submit all relevant documents for review [but that is not] very suitable for our company structure to do so. So, we don't want to do that and it is very simple if you don't want to do that: you can't have American users. Honestly it is not reasonable for the US to do this
> . . . .
>
> [U.S. regulators] can't make a special case for us. We are already doing a lot of things that are obviously not in line with the United States.

114. Zhao has kept information reflecting Binance's U.S. customer base secret even from certain senior managers and has been cautious in circulating internal materials to a broad audience due, at least in part, to the risk that inculpatory information could be leaked to regulators or other law enforcement personnel. On information and belief, Binance refers to this type of risk as "leak risk." For example, in a March 2019 discussion regarding the circulation of data that categorized Binance users by geographic location, Zhao said "Let me see it first then, and not distribute it, especially guys who have to deal with US regulators." And in an August 2020 chat, Zhao instructed a Binance employee that transaction volume data concerning U.S. API customers should not be published to a group; rather, such data should be sent only to Zhao.

H. Binance Has Guided United States Customers to Evade Its Compliance Controls Through the Use of VPNs and Other Creative Means

115. During the Relevant Period, Binance implemented IP address-based compliance controls that collect a customer's IP address and compare it to the list of countries Binance has purported to "restrict" from its platform. At least as of September 2019, the list of "restricted" jurisdictions included the United States. Nonetheless, Binance's IP address-based compliance controls, sometimes called "geofencing," have not been effective at preventing customers from "restricted" jurisdictions including the United States from accessing and trading on the Binance platform.

116. One reason Binance's IP address-based compliance controls have not been effective is that Binance has instructed U.S. customers to evade such controls by using VPNs to conceal their true location. VPNs have the effect of masking an internet user's true IP address. VPN use by customers to access and trade on the Binance platform has been an open secret, and Binance has consistently been aware of and encouraged the use of VPNs by U.S. customers.

117. At least as early as April 2019, Binance published a guide on the "Binance Academy" section of its website titled "A Beginner's Guide to VPNs." Binance's VPN guide explained to Binance customers that "[i]f you want to be private about the websites you visit – and your location – you should use a VPN." Binance's VPN guide also hints: "you might want to use a VPN to unlock sites that are restricted in your country."

118. Binance's senior management, including Zhao, knew the Binance VPN guide was used to teach U.S. customers to circumvent Binance's IP address-based compliance controls. In a March 2019 chat, Lim explained to his colleagues that "CZ wants people to have a way to know how to vpn to use [a Binance functionality] . . . it's a biz decision." And in an April 2019 conversation between Binance's Chief Financial Officer and Lim regarding Zhao's reaction to

controls that purported to block customers attempting to access Binance from U.S.-based IP addresses, Lim said: "We are actually pretty explicit about [encouraged VPN use] already – even got a fking guide. Hence CZ is ok with blocking even usa."

119. Binance senior management, including Lim, have used other workarounds to indirectly instruct Binance customers to evade Binance's IP address-based compliance controls. For example, in a July 8, 2019, conversation regarding customers that ought to have been "restricted" from accessing the Binance platform, Lim explained to a subordinate: "they can use vpn but we are not supposed to tell them that . . . it cannot come from us . . . but we can always inform our friends/third parties to post (not under the umbrella of Binance) hahah."

120. Lim continued his crafty efforts to assist Binance customers in circumventing Binance's compliance controls, as documented in a February 12, 2020 chat:

> Employee: hi Samuel, we are helping [an intermediary] to integrate with us to introduce new users and trade liquidity, but find most of their users are from US. Now Binance.com block US IP from registration. May I ask whether it is still a hard requirement nowadays?
>
> Lim: Yes, it still is. Because if US users get on .com we become subjected to the following US regulators, fincen ofac and SEC. But as best we can we try to ask our users to use VPN or ask them to provide (if there are an entity) non-US documents. On the surface we cannot be seen to have US users but in reality we should get them through other creative means.

121. Binance's use of creative workarounds to its compliance controls is further documented in a July 17, 2020 chat in which Lim clarified to a colleague:

> No we cannot change their status to non us if they are us
> Thats fraud
> But we can encourage them to be a non kyc account
> Or use a vpn
> . . .
>
> Yea can bypass [limitations on non-KYC accounts, such as withdrawal limits], give a little hand
> that you guys can work something out

please be clear we only do this for our biggest traders/VIPs

. . .

this is SPECIAL treatment

122. Lim also used Binance.US as a laboratory to identify important U.S. customers that could be prioritized for expedited on-boarding to the Binance platform. In a July 15, 2020 chat, Lim explained to a Binance employee that he should first ask a prospective customer "to onboard with US, then if their volume is really very big we will push hard on .com to accept it on an exceptional basis . . . CZ will definitely agree to this lol." Lim continued: "but they need to really be doing sick ass volumes . . . we always have a way for whales." Lim reiterated this procedure in a July 27, 2020 chat, explaining that "getting on .com" would be "an issue" for a prospective customer with "US beneficial owners" but that the prospective customer could "of course get on Binance US and then if the volumes are good, we can find a way to backdoor them to .com."

I. Binance Has Directed Its VIP Customers to Evade Compliance Controls, Including Through Submission of "New" KYC Documents

123. In addition to instructing retail customers located in the United States to use VPNs to avoid IP address-based compliance controls, Binance has also created special policies and procedures to help its VIP customers evade Binance's compliance controls so Binance could continue to access and derive profits from U.S. customers. Binance designed these special policies and procedures to help VIP customers evade both IP address-based compliance controls and KYC documentation-based compliance controls.

124. In February 2019, Lim and Zhao met in person to discuss how to address the regulatory risk stemming from Binance's U.S. customers that access Binance via API. These customers are generally institutional market participants and include VIPs. In advance of their meeting, Lim sent Zhao a numbered list of "Compliance parameters," including that "US API

users (identified through IP) will have 2 options. They can remain on main exchange or move over to US exchange," while "US API users (identified through KYC) have to move over to US exchange, they don't have a choice. We will notify them through Email."

125. Right after meeting with Lim, Zhao sent the compliance parameters to other senior managers, one of whom replied to Zhao that "[US users, with US, non international KYC] is [where] we will get nailed." The senior manager asked Zhao if Binance had to "enforce" the contemplated block of US API users identified through KYC "in the matching engine? That's the only way to guarantee this doesn't break. [It] is not a hard thing to enforce in the matching engine." Zhao replied: "let's worry about enforcement in a later stage, think we may have to do it by users."

126. On June 13, 2019, Binance released a press release that "announced its partnership with BAM Trading Services Inc. to begin preparation to launch trading services for users in the United States." While outwardly preparing for the launch of Binance.US, internally, Zhao, Lim, and other key Binance personnel remained focused on retaining U.S. VIP customers, and the liquidity and revenue they supplied, on Binance.

127. In and around June 2019, Zhao, Lim, and other key Binance personnel engaged in a series of strategy sessions concerning the retention of U.S. VIPs on the Binance platform. One method discussed was to instruct U.S. VIP customers to submit "new" KYC documentation in connection with a "new" account. This approach would allow VIP customers to continue to trade on Binance and maintain their preferential VIP status and benefits that resulted from their historical trading activity on Binance. During one meeting that Binance recorded, a senior employee proposed that Binance instruct U.S. customers to submit "new" KYC documentation

over social media—but Lim corrected the employee and mandated that such instructions should only occur in secret.

128. Binance's plan to instruct U.S. VIP customers to submit "new" KYC documentation was devised by Zhao. During a June 24, 2019 meeting with senior management, Zhao stated: "We do need to let users know that they can change their KYC on Binance.com and continue to use it. But the message, the message needs to be finessed very carefully because whatever we send will be public. We cannot be held accountable for it." In a meeting the next day, a senior VIP team member and Zhao engaged in the following colloquy:

> VIP team member: We don't tell them explicitly because that's marketing. But they [referring to U.S. VIP customers] understand . . . they know to send [their digital assets] the blockchain, then that's their own control. And then so they send it to themselves, but we just help them expedite. As we speed up the account of the corporate account of the BVI or Cayman entity.
>
> Zhao: Okay, so is this them creating a new account, but we talked about having them change KYC has that ever been done?
> . . . .
>
> VIP team member: We quietly mentioned to them that, you know, US, you know, it could be an issue and you know, if they have any offshore entities, maybe they should open another one as well for their offshore entities. That's how, that's how we, that's how we've been telling them. We haven't really sent anything blasting because that's, that's sensitive. That's marketing. I mean, [a U.S.-based compliance consultant] can comment on that.

129. Binance personnel began assisting U.S. VIP customers in creating "new" accounts using "new" KYC documentation as early as June 2019, and reported directly to Zhao on their efforts. For example, in a Binance group chat dated June 12, 2019, a Binance employee directed the following message to "@czhao," which is a handle used by Zhao:

> Today our VIP team talked with three VIP8 users, we didn't talk too much details and they all satisfied that we can help them onboarding their new non-US corporate accounts. That's a good start, we'll contact more VIPs tmr.

Zhao responded in the same chat: "cool."

130. At some point before October 2020, Binance formalized its processes for instructing U.S. VIP customers on the best methods to evade Binance's compliance controls in a corporate policy titled "VIP Handling." Zhao contributed ideas that were incorporated into the VIP Handling policy. Pursuant to the VIP Handling policy, once a customer service representative "hands the affected user over to VIP," the VIP team would "[m]ake sure the user has completed his/her new account creation with no U.S. documents allowed." U.S. VIP customers often followed these instructions by submitting "new" KYC documentation associated with a shell company incorporated in a jurisdiction other than the United States, such as the British Virgin Islands, to act as the nominee for the "new" account.

131. Acting pursuant to the VIP Handling policy, Binance's VIP team would then "coordinate the transfer" of the VIP customer's "Referral Bonuses, VIP level, Withdrawal Limits etc." to the "new" account from the VIP customer's pre-existing account. Thus, if the VIP team followed the VIP Handing policy correctly, from the customer's perspective nothing about their trading on Binance would be disrupted—the "new" account would be the same as the old account with the exception of the name of the accountholder.

132. Recognizing the evasive nature of the procedures and strategies memorialized in the VIP Handling policy, the document required Binance employees to "[m]ake sure to inform user to keep this confidential." In line with the intent to keep any "new account creations" by U.S. VIPs a secret, Zhao instructed during his October 13, 2020 "daily call" that any communications about the "US ban" should be done over the Signal messaging application. Thereafter, Lim circulated Zhao's directive to a senior compliance staff member in a chat, explaining: "we do all U.S. comms via signal as mandated by cz."

133. Binance's VIP Handling policy also established methods for Binance personnel to troubleshoot for U.S. customers that were identified as such through their IP address (as opposed to KYC documentation). For these customers, Binance instructed its personnel to "[i]nform the user that the reason why he/she cant use our www.binance.com is because his/her IP is detected as US IP. If user doesn't get the hint, indicate that IP is the **sole** reason why he/she can't use .com" [emphasis in original]. Lim flagged a passage in the VIP Handling policy for his colleagues that further explained: "We cannot teach users how to circumvent the controls. If they figure it out on their own, its fine."

134. Displaying the ecosystem's tone at the top, Zhao helped manage the implementation of Binance's VIP Handling policy. On October 9, 2020, around the time Binance began sending emails to U.S. customers pursuant to the policy, Zhao had the following exchange with an employee who would ultimately become Binance's head of institutional sales:

> VIP team member: Hi CZ . . . I went through list of affected API clients, it includes a number of large strategic accounts including [a Chicago-headquartered trading firm] who is currently is a top 5 client and 12% of our volume
>
> Zhao: Give them a heads up to ensure they don't connect from a us Ip. Don't leave anything in writing. They have non us entities. Let's also make sure we don't hit the biggest market makers with that email first. Do you have signal?

135. At least until August 2021, over two years after Binance updated its Terms of Use to "restrict" U.S. customers, Binance employees continued to observe customers they had previously identified as U.S. VIPs trading on the platform. In an August 14, 2021 chat, members of the VIP and Compliance teams discussed the issue:

> Compliance employee: We have two corporate clients . . . which were detected as US nexus (US UBOs > 50%). Considering they are big clients, our compliance team wants to further check with you if we need to talk with the clients and give them a period before going offboard. Please advise. Thank you.

> VIP team member 1: we've gone through multiple offboarding exercises how is this coming up again?
>
> VIP team member 2: I guess because they're a big client so there were delays here and there previously . . . there are still transactions going on during the month of august hahaha scary indeed.

136. Binance's efforts to hold itself out as "compliant" while at the same time taking steps to assist customers in submitting "new" KYC documents has continued. For example, on August 5, 2021, Binance posted an announcement to Binance.com titled "Updates to API Services" that states:

> To ensure a safe and fair trading environment for all users and remain compliant with the latest industry requirements, Binance is updating its API services to limit new API key creation by accounts that have only completed basic account verification. This update is effective starting 2021-08-09 03:00 (UTC).
>
> For accounts that have not completed intermediate verification, any existing API keys will be changed to "read only" after 2021-08-23 00:00 AM (UTC). Trading functions via relevant API keys will be deactivated. Users can complete intermediate verification to reset API access and resume trading functions.

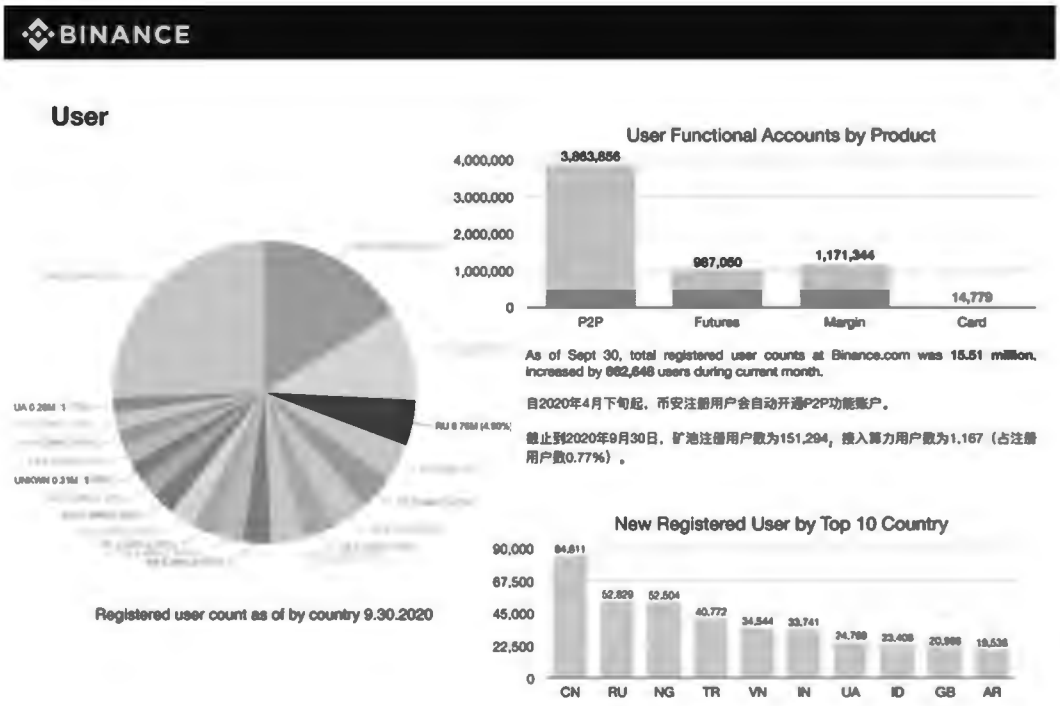
But internal documents confirm that Binance was still up to its old tricks as of August 5, 2021. In a presentation concerning business operations that occurred during the week of August 9 through August 15, 2021, Binance personnel noted that they had made progress "Follow[ing] up [with high] value users KYC projuect [sic]."

J. Binance Knowingly Concealed the Presence of United States Customers In Internal Documents and Data

137. Zhao wanted U.S. customers, including VIP customers, to transact on Binance because it was profitable for Binance to retain those customers. Binance has tracked the sources of its revenues by customers' geographic location, among other analytical methods. Zhao routinely received reporting that unambiguously demonstrated that U.S. customers contributed a substantial amount of Binance's revenues. For example, Binance tracked revenues derived from U.S. customers and summarized that information in the Binance monthly revenue reports. In

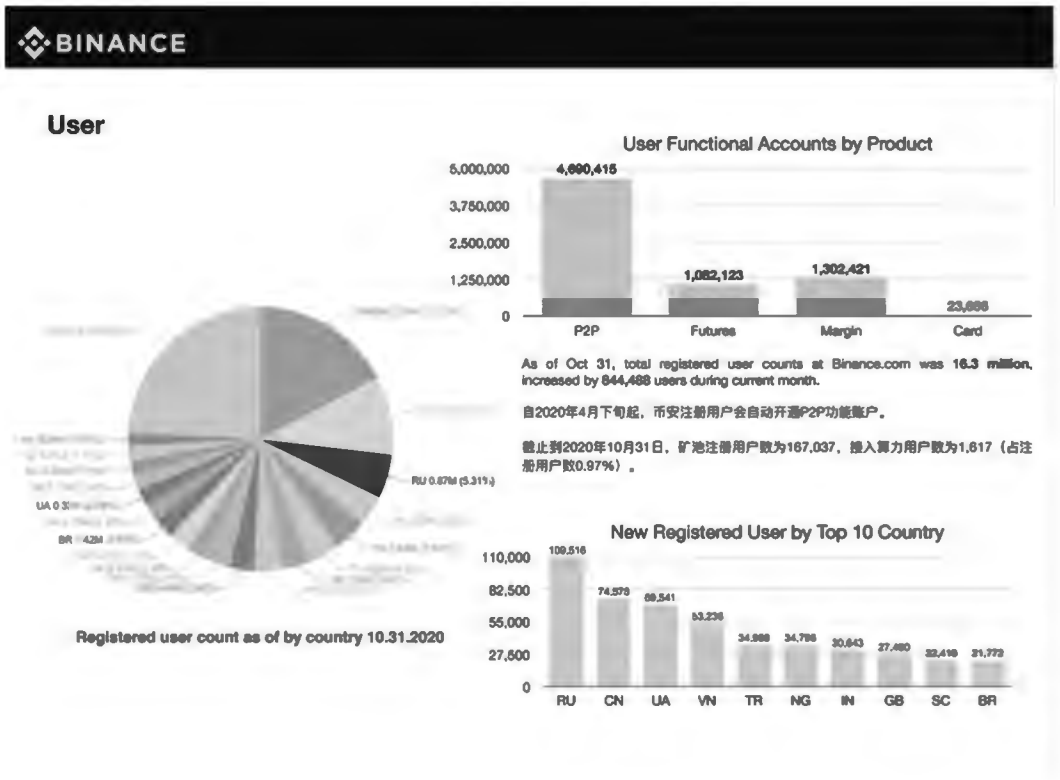
addition, Binance's "Futures Team" created periodic reports that showed the trading volume, revenue to Binance, and other account and transactional information concerning U.S. customers' derivatives trading.

138. Binance's revenue reports rely on data drawn from Binance's internal database. The monthly revenue report for September 2020 reflects that 2.51 million customers were located in "U.S." That same month, Binance's revenue report shows 0.31 million Binance customers' locations were "UNKWN." This report, provided to Zhao and at least certain members of Binance senior management, showed:



139. Then in October 2020, the same month a rival digital asset exchange and its principals were sued by the CFTC, Zhao directed Binance personnel to replace the U.S. value for certain data fields in Binance's internal database with the value UNKWN. As a result, Binance's October 2020 monthly revenue report identified approximately 2.83 million customers' locations as UNKWN, while omitting any reference to U.S. Thereafter, Binance's revenue reports

continued to attribute U.S.-derived customers and revenue to UNKWN and did not reflect the presence of any customers from the U.S. The October 2020 report, also provided to Zhao and at least certain members of Binance senior management, showed:



140. It is widely understood by Binance personnel that UNKWN is a code word for United States for purposes of interpreting Binance's internal documents and data. For example, on October 2, 2020, Binance's Director of Operations told a colleague: "The recent Bitmex incident has had a great impact on the industry. Please remove US data from all our charts together with Big Data. Everyone in the future will not see our US data, except for financial and very few people." And in a November 17, 2020 internal chat, the Director of Operations explained: "at present, the keyword US for internal information is also a sensitive word, so you have to use Unknow to mark the country."

K. Binance Has Relied On "Brokers" to Introduce Customers to the Binance Platform Without Effective Access Controls

141. During the Relevant Period, Binance implemented a "broker program" pursuant to which third parties introduce customers to the Binance platform. Binance did not have effective controls in place—beyond Binance's own ineffective access controls—to ensure these brokers did not permit their own customers to access Binance from the United States or any other "restricted" jurisdiction during the Relevant Period.

142. The participants in Binance's broker program include "exchange brokers" that allow their customers to transmit orders directly into Binance spot and derivatives markets. In addition, during the Relevant Period Binance has relied on "prime brokers" to solicit and accept orders for Binance's digital asset derivatives from institutional customers, including those located in the United States.

143. While Binance's Terms of Use state that a "Binance Account can only be used by the account registrant," Binance does not uniformly enforce this provision. During the Relevant Period, Binance has knowingly allowed at least two "prime brokers" to open "sub-accounts" through which U.S. customers have and continue to trade digital asset derivatives on the Binance platform.

144. Prime Broker A is a British Virgin Islands entity. Its CEO resides and works in New York and its sales force includes personnel that reside and work in the United States.

145. Prime Broker A's customers include institutional market participants that are located in the United States. Prime Broker A holds a "main account" on Binance. For each of its customers, Prime Broker A opens one or more new "sub-accounts" on Binance under Prime Broker A's "main account." Binance does not collect any identity-verifying documentation

when Prime Broker A opens up new "sub-accounts" on behalf of its customers or otherwise attempt to learn the identity of Prime Broker A's customers.

146. Prime Broker A's U.S.-based customers transmit orders to Binance directly through API connections that Binance attributes to Prime Broker A. Binance is aware that Prime Broker A allows its customers to trade on Binance through Prime Broker A's "sub-accounts."

147. Prime Broker B is an entity organized under the laws of Malta. Prime Broker B's CEO resides and works in California and Prime Broker B's sales force includes personnel that reside in the United States.

148. Prime Broker B holds a "main account" on Binance. For each of its customers, Prime Broker B opens one or more new "sub-accounts" on Binance under its "main account." Binance does not collect any identity-verifying documentation when Prime Broker B opens up new "sub-accounts" on behalf of its customers or otherwise attempt to learn the identity of Prime Broker B's customers.

149. Prime Broker B's customers include institutional market participants that are located in the United States, including Trading Firm A. Binance is aware that Prime Broker B allows its customers to trade on Binance through Prime Broker B's "sub-accounts."

L. Examples of Market Participants Currently Trading on Binance and Binance's Efforts to Help Them Evade Its Compliance Controls

Trading Firm A

150. Trading Firm A is a quantitative trading firm that has traded bitcoin perpetuals on Binance, among other products, through at least three different accounts during the Relevant Period. Trading Firm A is a Delaware limited liability company headquartered in Chicago, Illinois. Trading Firm A also has offices in New York and Amsterdam.

151. Trading Firm A is majority owned by U.S. residents. Its executive management, including Trading Firm A's two principals, one of whom functions as its Chief Risk Officer and one of whom functions as its Chief Technology Officer ("CTO"), work from Trading Firm A's Chicago headquarters. Trading Firm A's personnel access Binance.com through VPNs.

152. Trading Firm A's trading activity on Binance is conducted through automated trading strategies programmed into computer algorithms. These algorithms determine whether to place or cancel any orders based on instructions in their code. Trading Firm A's algorithms are developed by quantitative technologists that work at Trading Firm A's Chicago headquarters, among other locations. The algorithms are built using computer code that Trading Firm A considers to be valuable intellectual property. Trading Firm A's computer code and its algorithms are owned by an Illinois limited liability company that is a wholly-owned subsidiary of Trading Firm A.

153. At all times, whether trading in a Binance account in its own name, in the name of a foreign-incorporated nominee subsidiary, or through a sub-account opened on its behalf by Prime Broker B, Trading Firm A has been the real economic party to its trading activity on Binance. Trading Firm A has capitalized its trading activity on Binance and Trading Firm A's net trading revenue derived from its trading activity on Binance is consolidated into Trading Firm A's financial statements.

154. At the time it maintained an account directly on Binance, Trading Firm A benefited from its status as a VIP customer. Binance provided Trading Firm A with the "incentive" of "lower latency access [to Binance's matching engine] for up to 2 IP addresses," Trading Firm A received exceptions to Binance's default order-messaging limits, and Trading Firm A received reduced trading fees relative to non-VIP customers.

155. Trading Firm A has conducted its trading activity on Binance through a series of accounts during the Relevant Period. First, beginning before the Relevant Period, Trading Firm A conducted its trading activity on Binance through a "personal" account registered under the name of one of Trading Firm A's principals, who is a U.S. citizen that resides in Illinois.

156. In June 2019, a Binance Key Account Manager instructed Trading Firm A to "switch the account KYC." Following Binance's instructions, Trading Firm A opened a "new" Binance account in August 2019 in the name of a wholly-owned subsidiary incorporated in the Cayman Islands. Substantially all personnel that perform work for this Cayman Islands nominee entity are employed by Trading Firm A or its subsidiaries and Trading Firm A controls all aspects of its Cayman Islands subsidiary. During the account opening process, Binance instructed Trading Firm A to access the Binance website through a VPN to avoid Binance's IP-address based compliance controls. Once this account was opened, Trading Firm A transferred all of its trading activity, and Binance transferred Trading Firm A's VIP status and benefits, to the "new" account. Trading Firm A did not make any material changes in the way it traded on Binance in August 2019, other than the name on the account.

157. In December 2020, Binance sent Trading Firm A an email that stated that Trading Firm A had "identified [itself to Binance] as a U.S. Person." Following numerous telephone conferences with Binance personnel concerning their "corporate structure," Trading Firm A, again with the assistance of Binance personnel, opened a "new" account held by a different nominee shell entity in April 2021. This time, the nominee was a Netherlands entity that was 100 percent capitalized by Trading Firm A. Once this "new" Binance account was opened, Binance transferred Trading Firm A's VIP status and benefits to the new account. Trading Firm

A did not make any material changes in the way it traded on Binance in April 2021, other than the name on the account.

158. In or around August 2021, Binance told Trading Firm A that it was no longer permitted to trade derivatives on Binance but, on information and belief, took no further action at that time. Approximately three months later, in or around November 2021 Trading Firm A temporarily discontinued its trading activity on Binance.

159. In or around January 2022, Trading Firm A began discussing opening an account with Prime Broker B. Prime Broker B offered Trading Firm A "direct exchange access [to Binance] with no . . . intermediation if you can pre-fund the trades." Trading Firm A explained to Prime Broker B: "the market we are most interested in right now would be Binance Futures" but "Binance does not let us use [the Netherlands nominee entity to trade derivatives]" and "[o]ur other entities are either US based or have US UBOs." Prime Broker B responded that it could "definitely" allow Trading Firm A to "trade futures [on Binance] via our non-US [Prime Broker B] entity."

160. Shortly thereafter, Trading Firm A opened an account with Prime Broker B in the name of its Cayman Islands-incorporated subsidiary referenced in paragraph 156 and resumed its trading activity on Binance through Prime Broker B's Binance "sub-accounts." Trading Firm A has continued to trade bitcoin perpetuals, among other products, on Binance and has not made any material changes to the manner in which it trades on Binance, other than that it is now trading through intermediated access.

161. At all times, whether trading in an account in its own name, in the name of a foreign-incorporated nominee subsidiary, or through a sub-account opened on its behalf by Prime Broker B, the development and control of Trading Firm A's algorithms, the capitalization

of its trading activity, and the location of the company's senior management has remained the same.

Trading Firm B

162. Trading Firm B is a quantitative trading firm headquartered in New York and incorporated in Delaware. Trading Firm B has at all relevant times been ultimately majority owned by U.S. residents. Numerous senior managers, including the individual who functions as Trading Firm B's CEO, have worked from Trading Firm B's New York headquarters. Trading Firm B also has offices in London, Amsterdam, Hong Kong, and Singapore. Trading Firm B uses "proxy servers" to access the internet. Like VPNs, proxy servers obscure an internet user's true IP address.

163. Trading Firm B conducts its digital asset trading activity on Binance through a dedicated trading desk that utilizes automated trading strategies programmed into computer algorithms developed by personnel at Trading Firm B's New York headquarters, among other locations. Trading Firm B's algorithms determine whether to place or cancel any orders based on the instructions in their code. Trading Firm B's algorithms are built using computer code that Trading Firm B considers to be valuable intellectual property. Trading Firm B's computer code is owned, directly or by assignment from its various wholly-owned subsidiaries, by Trading Firm B.

164. The global head of Trading Firm B's digital asset trading desk works from Trading Firm B's New York headquarters. Other employees, including members of the business development team responsible for interacting with Binance, also work from Trading Firm B's New York headquarters.

165. Trading Firm B has been among Binance's largest customers and has consistently received reduced trading fees due to its status as a Binance VIP. Binance has also permitted

Trading Firm B to exceed Binance's default order-messaging limits and has "whitelisted" Trading Firm B's API connections to the platform's matching engines so Trading Firm B can "benefit from lower latency and stability" relative to customers that do not have "whitelisted" connections. Binance personnel explained to Trading Firm B that Binance's: "low-latency futures api/fstream . . . carry a different domain than the public fapi/fstream . . . which will route to a more dedicated machine/gateway that open exclusively for MM and top tier VIP clients. So generally client can expect a slight 5-10ms latency reduction on roundtrip for normal trading environment and more normalized latency distribution (less extreme tail) in busy environment."

166. Beginning in July 2018, prior to the Relevant Period, Trading Firm B began trading digital assets in Binance's spot markets through an account held in the name of a wholly-owned Hong Kong-incorporated subsidiary.

167. On February 13, 2020, Trading Firm B tried to "open a futures account" and received an "error message." Senior Binance personnel then concluded this may have been due to "US ip" or that "the UBO would be a US person." Binance employees chatted: "How annoying," and surmised that Trading Firm B's account was "[g]randfathered" from "back before [Binance] screened for" the location of its customers. After confirming that Trading Firm B was a "US entity in our system," Binance employees conferred with Trading Firm B's New York-based cryptocurrency business development personnel and "discussed with him (a) short term opening a personal account and (b) moving this personal account to their HK legal entity in medium term."

168. The next day, February 14, 2020, a Trading Firm B employee who is a resident of the United Kingdom opened a personal account on Binance. Trading Firm B then began to

conduct its digital asset derivative trading activity in that account and would ultimately conduct substantially all of its corporate trading activity through this "personal" account for several years.

169. In August and September 2020, Trading Firm B asked Binance "to transfer [its] VIP status from" the account held in the name of Trading Firm B's Hong Kong-incorporated subsidiary to the "personal" account held in the name of their United Kingdom-based employee. In January 2021, Binance confirmed that it understood Trading Firm B was trading on Binance through a "personal" account and at all times applied the VIP benefits associated with Trading Firm B's corporate trading activity to this "personal" account.

170. Trading Firm B continued to trade BTC perpetuals and other derivative products through its "personal" account until approximately October 2022. Binance routinely communicated with Trading Firm B about the activity in Trading Firm B's "personal" account, including through email to addresses with the domain @[tradingfirmb].com, and interacted with Trading Firm B personnel in a Telegram chat group titled "Binance < > [Trading Firm B]."

171. On March 11, 2022, Trading Firm B submitted KYC documents to Binance concerning an application for a "new" Binance account to be held by a nominee shell company organized under the laws of Jersey. The shares of this new nominee entity are "owned" by a third party that has no affiliation with Trading Firm B and does not exercise any control over Trading Firm B's trading activity on Binance.

172. Trading Firm B's Jersey nominee does not have any employees and does not have any meaningful sources of capital, apart from Trading Firm B. Trading Firm B's Jersey nominee has entered into at least two contracts with Trading Firm B subsidiaries. First, a "Services Agreement." Under the terms of that agreement, a Trading Firm B subsidiary agrees to provide office space, personnel, technology, information technology support, including maintenance of

all services and systems databases, and "any services as the parties may agree from time to time." Second, a "Confirmatory Note." Under the terms of that note, a Trading Firm B subsidiary agrees to transfer funds to Trading Firm B's Jersey nominee for the purpose of engaging in "Nominee Trading Activities." In return, Trading Firm B's Jersey nominee agrees to provide Trading Firm B with the "Net Proceeds" of its nominee trading activity on Binance.

173. On March 17, 2022, a New York-based Trading Firm B employee wrote to Binance: "I'm currently trying to make sure we can get our account entity-verified before the May 15 deadline . . . . We've been trying to set up a new account . . . do you think you could help us get more color on what info [Binance is] looking for?" A Binance salesperson responded:

> I am channeling internally with the onboarding agent reviewing the case . . . . On the deadline [to open a new account], don't worry, we will apply for a whitelisting for a couple of more weeks so there is no risk of trading disruption . . . . We cannot apply the new [KYC] documents to the existing account because it is a Personal Account. Once the corporate one is approved, we will help migrating with the ad hoc setups it might have.

On April 7, 2022, Trading Firm B received an email from Binance concerning the contemplated "new" account that read: Corporate Verification Successful.

174. Despite the "successful" corporate verification, Trading Firm B continued to trade through its "personal" account and on July 5, 2022, asked Binance if "it [would] be possible to apply the limits and mm levels to the new account immediately?" Binance responded that it had "good news" that it could "migrate" Trading Firm B's "personal account (the one you guys are currently using for trading)" to the new account held by Trading Firm B's Jersey nominee following "exceptional approval." Still trading through its "personal" account as of October 6, 2022, Trading Firm B sent a Telegram message to Binance outlining "some things . . . to make

sure get reflected in the new account to match our existing account," including "rate limits, fee tiers/mms status, [and] withdrawal limits." Binance responded: "we can do all."

175. Ultimately, Trading Firm B did not even need to migrate its trading activity despite applying for a "new" account and getting "exceptional approval" from Binance. Instead, Binance just swapped out the name on Trading Firm B's "personal" account with the name of the Jersey nominee. Everything else—VIP benefits, preferential matching engine access, open positions, even the account number—stayed the same. Trading Firm B continues to trade on Binance, including in digital asset derivative products such as bitcoin perpetuals.

176. Trading Firm B has been the real economic party to Trading Firm B's trading activity on Binance at all times no matter what the name on its account has been. Trading Firm B has at all times capitalized Trading Firm B's trading activity on Binance and the net trading revenue derived from its trading activity on Binance has been consolidated into Trading Firm B's financial statements.

Trading Firm C

177. Trading Firm C, another quantitative trading firm that trades digital asset derivatives on Binance through automated trading strategies, is headquartered and incorporated in New York. Trading Firm C is majority owned by U.S. residents and the individual with the largest ownership share is also a U.S. citizen. Trading Firm C trades in numerous financial markets around the globe and is part of a corporate "umbrella" of commonly controlled affiliates and subsidiaries that has branch offices in London, Singapore, and Hong Kong, among other locations.

178. Zhao has communicated directly with Trading Firm C's CEO, who has a New York phone number. In one Signal text chain, Trading Firm C's CEO messaged to Zhao:

> Hello CZ. This is [first name of the CEO] from [Trading Firm C]. Firstly I wanted to reach out and thank you for meeting with me and my team several weeks ago. Secondly, I also kindly wanted to follow up with [you] regarding the day limit on Spot. I have been struggling internally with my portfolio management teams to get traction on increasing the day limit as we are looking to expand our trading as well as bring on a few more portfolio teams onto the platform. Please let me know when it would be a convenient time to discuss with you. Thank you. We had heard that we would be expecting an increase last Friday but that did not happen, and we are not sure how to interpret.

Zhao replied within five minutes: "Looking into." Zhao has also been a member of a Signal group chat titled "Binance/[Trading Firm C's d/b/a]," that includes Trading Firm C's New York-based Chief Investment Officer.

179. Trading Firm C's trading activity on Binance is conducted through automated trading strategies that use tailor made computer algorithms that take in market data and other trading information to generate orders to send to market to fulfil the strategies' overall objectives. Development of Trading Firm C's algorithms used for trading on Binance occurs in the United States and in other locations.

180. Trading Firm C conducts its trading activity on Binance through at least 15 independent trading teams, including teams based in and managed from New York. Trading Firm C's trading teams are managed by "portfolio managers," who are responsible for the overall management of their respective trading teams, including trading strategy development. Most, if not all, of the relevant portfolio managers are physically located in the United States and some are partners in Trading Firm C.

181. Trading Firm C's trading activity, including its trading activity on Binance, relies on functionalities the development of which is supervised by three CTOs, two of whom are located in the United States and ultimately report to Trading Firm C's New York-based CEO.

182. Trading Firm C and its commonly-owned corporate affiliate (a Delaware limited liability company) have been the real economic party to Trading Firm C's trading activity on Binance at all times, regardless of whether it traded through accounts held by wholly-owned corporate subsidiaries or an off-shore nominee company. Trading Firm C's net trading revenue derived from its trading activity on Binance is consolidated into the financial statements of Trading Firm C's commonly-owned Delaware-incorporated affiliate and combined into Trading Firm C's financial statements.

183. Initially, Trading Firm C traded on Binance through an account opened in the name of a Singapore-incorporated subsidiary. In approximately October 2021, Trading Firm C "migrated" its Binance trading activity to an account opened under the name of a corporate entity that is organized under the laws of the Cayman Islands. Binance confirmed that the "migration" would have "no impact on [Trading Firm C's] trading." Consistent with this representation, Binance ported over Trading Firm C's VIP status including its reduced trading fees, as well as Trading Firm C's low latency connection to Binance's matching engines and ability to exceed Binance's default order-messaging limits to the "new" account.

184. In connection with the opening of the "new" account, Trading Firm C informed Binance that it "structured" its Cayman Islands-incorporated nominee to roll up to a trust that owns certain "voting" shares but "does not hold any participating shares so all economic interest flows through [a holding company] and then to [Trading Firm C's commonly-owned domestic affiliate] as the sole shareholder of the participating shares" so that Trading Firm C "retains all decision making power and economic interest" in its Binance account. Trading Firm C explained to Binance that the "main reason for using this structure is to comply with the Binance requirements" concerning "US beneficial ownership."

185. Consistent with its understanding that the trading activity in the "new" account held by the Cayman nominee is attributable to Trading Firm C, Binance has communicated about that account with Trading Firm C personnel that use @[trading-firmc].com email addresses and through Telegram chat groups with titles that include "Binance" and "Trading Firm C."

186. Trading Firm C continues to trade digital asset derivative products on Binance, including bitcoin perpetuals.

VI. VIOLATIONS OF THE COMMODITY EXCHANGE ACT AND REGULATIONS

COUNT I

Violations of Section 4(a) of the Act, 7 U.S.C. § 6(a), or, alternatively, Section 4(b) of the Act, 7 U.S.C. § 6(b) and Regulation 48.3, 17 C.F.R. 48.3 (2022)

Execution of Futures Transactions on an Unregistered Board of Trade

187. The allegations set forth in paragraphs 1 through 186 are re-alleged and incorporated herein by reference.

188. During the Relevant Period, Defendants Binance Holdings, Binance IE, and Binance Services, all acting as a common enterprise and doing business as Binance, and through their officers, employees, and agents, violated and are continuing to violate 7 U.S.C. § 6(a) by:

a. offering to enter into retail commodity transactions, or contracts for the purchase or sale of digital assets that are commodities for future delivery;

b. entering into retail commodity transactions, or contracts for the purchase or sale of digital assets that are commodities for future delivery;

c. confirming the execution of retail commodity transactions, or contracts for the purchase or sale of digital assets that are commodities for future delivery; and

d. conducting an office or business in the U.S. for the purpose of soliciting, or accepting any order for, or otherwise dealing in, any transaction in, or in connection

with, retail commodity transactions or contracts for the purchase or sale of digital assets that are commodities for future delivery;

without conducting its futures transactions on or subject to the rules of a board of trade that was designated or registered by the CFTC as a contract market.

189. Binance's retail commodity transactions are and were offered, entered into on a leveraged or margined basis, or are and were financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis.

190. Binance's retail commodity transactions are and were offered to, entered into with persons who are not eligible contract participants or eligible commercial entities and who are not engaged in a line of business related to cryptocurrencies.

191. In the alternative, during the Relevant Period, Defendants Binance Holdings, Binance IE, and Binance Services, all acting as a common enterprise and doing business as Binance, and through their officers, employees, and agents, violated and are continuing to violate 7 U.S.C. § 6(b) and Regulation 48.3, 17 C.F.R. § 48.3 (2022), by permitting direct access to its electronic trading and order matching system without obtaining an Order of Registration for a foreign board of trade from the Commission.

192. Each offer to enter into, entrance into, execution of, and/or confirmation of the execution of illegal off exchange futures transactions, including, without limitation, those specifically alleged herein, is alleged as a separate and distinct violation of 7 U.S.C. § 6(a) or, alternatively, 7 U.S.C. § 6(b) and 17 C.F.R. § 48.3.

193. During the Relevant Period, Zhao directly or indirectly controlled Binance, and did not act in good faith or knowingly induced, directly or indirectly, the acts constituting Binance's violations described in this Count. Therefore, pursuant to Section 13(b) of the Act,

7 U.S.C. § 13c(b), Zhao is liable as a control person for Binance's violations described in this Count.

194. The acts and omissions of Zhao, Lim, and other officers, employees, or agents acting for Binance described in this Complaint were done within the scope of their office, employment, or agency with Binance. Therefore, pursuant to Section 2(a)(1)(B) of the Act, 7 U.S.C. § 2(a)(1)(B), and Regulation 1.2, 17 C.F.R. § 1.2 (2022), Binance is liable as a principal for each act, omission, or failure of the other officers, employees, or agents acting for Binance.

195. From July 2019 through at least January 2022 and while acting as Binance's Chief Compliance Officer, Lim willfully aided, abetted, counseled, commanded, induced, or procured the acts constituting Binance's violations described in this Count, or acted in combination or concert with any other person in any such violation, or willfully caused an act to be done or omitted which if directly performed or omitted by Lim or another would constitute a violation described in this Count. Pursuant to Section 13(a) of the Act, 7 U.S.C. § 13c(a), Lim is therefore liable for Binance's violations described in this Count to the same extent as Binance.

COUNT II

Violations of Section 4c(b) of the Act, 7 U.S.C. § 6c(b), and Regulation 32.2, 17 C.F.R. § 32.2 (2022)

Illegal Off-Exchange Commodity Options

196. Paragraphs 1 through 186 of this Complaint are re-alleged and incorporated herein by reference.

197. During the Relevant Period, Defendants Binance Holdings, Binance IE, and Binance Services, all acting as a common enterprise and doing business as Binance, and through their officers, employees, and agents, violated 7 U.S.C. § 6c(b) and Regulation 32.2 by offering

to enter into, entering into, confirming the execution of, maintaining positions in, and otherwise conducting activities relating to commodity option transactions in interstate commerce.

198. The commodity options that Binance offered to enter into, entered into, confirmed the execution of, maintained positions in, and otherwise conducted activities relating to, were not executed on any registered board of trade, nor has Binance sought registration as an exempt foreign board of trade.

199. Each act in violation of 7 U.S.C. § 6c(b) and 17 C.F.R. § 32.2, including, but not limited to, those specifically alleged herein, is alleged as a separate and distinct violation.

200. During the Relevant Period, Zhao directly or indirectly controlled Binance, and did not act in good faith or knowingly induced, directly or indirectly, the acts constituting Binance's violations described in this Count. Therefore, pursuant to 7 U.S.C. § 13c(b), Zhao is liable as a control person for Binance's violations described in this Count.

201. The acts and omissions of Zhao, Lim, and other officers, employees, or agents acting for Binance described in this Complaint were done within the scope of their office, employment, or agency with Binance. Therefore, pursuant to 7 U.S.C. § 2(a)(1)(B) and 17 C.F.R. § 1.2, Binance is liable as a principal for each act, omission, or failure of the other officers, employees, or agents acting for Binance, constituting violations of 7 U.S.C. § 6c(b) and 17 C.F.R. § 32.2.

202. From July 2019 through at least January 2022 and while acting as Binance's Chief Compliance Officer, Lim willfully aided, abetted, counseled, commanded, induced, or procured the acts constituting Binance's violations described in this Count, or acted in combination or concert with any other person in any such violation, or willfully caused an act to be done or omitted which if directly performed or omitted by Lim or another would constitute a

violation described in this Count. Pursuant to 7 U.S.C. § 13c(a), Lim is therefore liable for Binance's violations described in this Count to the same extent as Binance.

COUNT III

Violation of Section 4d of the Act, 7 U.S.C. § 6d

Failure to Register as a Futures Commission Merchant

203. Paragraphs 1 through 186 of this Complaint are re-alleged and incorporated herein by reference.

204. During the Relevant Period, Defendants Binance Holdings, Binance IE, and Binance Services, all acting as a common enterprise and doing business as Binance, and through their officers, employees, and agents, have operated as an FCM, and are continuing to operate as an FCM, by:

a. engaging in soliciting or accepting orders for the purchase or sale of commodities for future delivery;

b. engaging in soliciting or accepting orders for swaps;

c. engaging in soliciting or accepting orders for agreements, contracts or transactions described in Section 2(c)(2)(D)(i) of the Act [7 U.S.C. § 2(c)(2)(D)(i)] (retail commodity transactions); and/or

d. acting as a counterparty in agreements, contracts, or transactions described in Section 2(C)(2)(D)(i) of the Act [7 U.S.C. § 2(c)(2)(D)(i)];

and, in or in connection with these activities, accepting money, securities, or property (or extending credit in lieu thereof) to margin, guarantee, or secure resulting trades on the Binance platform.

205. During the Relevant Period, Defendants Binance Holdings, Binance IE, and Binance Services, all acting as a common enterprise and doing business as Binance, and through their officers, employees, and agents, violated and are continuing to violate 7 U.S.C. § 6d by failing to register with the Commission as an FCM.

206. Each act in violation of 7 U.S.C. § 6d, including, but not limited to, those specifically alleged herein, is alleged as a separate and distinct violation.

207. During the Relevant Period, Zhao directly or indirectly controlled Binance, and did not act in good faith or knowingly induced, directly or indirectly, the acts constituting Binance's violations described in this Count. Therefore, pursuant to 7 U.S.C. § 13c(b), Zhao is liable as a control person for Binance's violations described in this Count.

208. The acts and omissions of Zhao, Lim, and other officers, employees, or agents acting for Binance described in this Complaint were done within the scope of their office, employment, or agency with Binance. Therefore, pursuant to 7 U.S.C. § 2(a)(1)(B) and 17 C.F.R. § 1.2, Binance is liable as a principal for each act, omission, or failure of any officers, employees, agents, or other persons acting for Binance, constituting violations of 7 U.S.C. § 6d.

209. From July 2019 through at least January 2022 and while acting as Binance's Chief Compliance Officer, Lim willfully aided, abetted, counseled, commanded, induced, or procured the acts constituting Binance's violations described in this Count, or acted in combination or concert with any other person in any such violation, or willfully caused an act to be done or omitted which if directly performed or omitted by Lim or another would constitute a violation described in this Count. Pursuant to 7 U.S.C. § 13c(a), Lim is therefore liable for Binance's violations described in this Count to the same extent as Binance.

COUNT IV

Violations of Section 5h(a)(1) of the Act, 7 U.S.C. § 7b-3(1), and Regulation 37.3(a)(1), 17 C.F.R. § 37.3(a)(1) (2022)

Failure to Register as a Designated Contract Market or Swap Execution Facility

210. Paragraphs 1 through 186 of this Complaint are re-alleged and incorporated herein by reference.

211. During the Relevant Period, Defendants Binance Holdings, Binance IE, and Binance Services, all acting as a common enterprise and doing business as Binance, and through their officers, employees, and agents, violated and are continuing to violate 7 U.S.C. § 7b-3 and 17 C.F.R. § 37.3(a)(1) by operating a facility for the trading of swaps on digital assets that are commodities including BTC, ETH and LTC without registering with the CFTC as a DCM or a SEF.

212. Binance has operated and is continuing to operate a trading system or platform in which more than one market participant has the ability to execute or trade swaps with more than one other market participant on the system or platform, including the trading or processing of swap on digital assets that are commodities without being registered as a DCM or SEF.

213. Certain products that have traded on Binance, including "perpetual futures" or "perpetual contracts" on BTC, ETH and/or LTC are swaps as defined by 7 U.S.C. § 1a(47).

214. Each act in violation of 7 U.S.C. § 7b-3 and 17 C.F.R. § 37.3, including, but not limited to, those specifically alleged herein, is alleged as a separate and distinct violation.

215. During the Relevant Period, Zhao directly or indirectly controlled Binance, and did not act in good faith or knowingly induced, directly or indirectly, the acts constituting Binance's violations described in this Count. Therefore, pursuant to 7 U.S.C. § 13c(b), Zhao is liable as a control person for Binance's violations described in this Count.

216. The acts and omissions of Zhao, Lim, and other officers, employees, or agents acting for Binance described in this Complaint were done within the scope of their office, employment, or agency with Binance. Therefore, pursuant to 7 U.S.C. § 2(a)(1)(B) and 17 C.F.R. § 1.2, Binance is liable as a principal for each act, omission, or failure of the other officers, employees, or agents acting for Binance, constituting violations of 7 U.S.C. § 7b-3 and 17 C.F.R. § 37.3.

217. From July 2019 through at least January 2022 and while acting as Binance's Chief Compliance Officer, Lim willfully aided, abetted, counseled, commanded, induced, or procured the acts constituting Binance's violations described in this Count, or acted in combination or concert with any other person in any such violation, or willfully caused an act to be done or omitted which if directly performed or omitted by Lim or another would constitute a violation described in this Count. Pursuant to 7 U.S.C. § 13c(a), Lim is therefore liable for Binance's violations described in this Count to the same extent as Binance.

COUNT V

Violations of Regulation 166.3, 17 C.F.R. § 166.3 (2022)

Failure to Diligently Supervise

218. Paragraphs 1 through 186 of this Complaint are re-alleged and incorporated herein by reference.

219. During the Relevant Period, Defendants Binance Holdings, Binance IE, and Binance Services, all acting as a common enterprise and doing business as Binance, and through their officers, employees, and agents, violated and are continuing to violate 17 C.F.R. § 166.3 by employing an inadequate supervisory system and failing to perform their supervisory duties diligently. More specifically, Binance violated and is continuing to violate 17 C.F.R. § 166.3 by, among other things, (i) failing to implement an effective Customer Information Program;

(ii) failing to implement effective Know-Your-Customer procedures; (iii) failing to implement effective Anti-Money Laundering procedures; (iv) failing to ensure that its partners, officers, employees, and agents, lawfully and appropriately handled all commodity interest accounts at Binance; (v) purposefully instructing customers to evade compliance controls; and, (vi) intentionally destroying documents related to illegal conduct.

220. Binance is and has been acting as an FCM, and therefore 17 C.F.R. § 166.3 applies to Binance as if it were a Commission registrant.

221. Each act in violation of 17 C.F.R. § 166.3, including, but not limited to, those specifically alleged herein, is alleged as a separate and distinct violation.

222. During the Relevant Period, Zhao directly or indirectly controlled Binance, and did not act in good faith or knowingly induced, directly or indirectly, the acts constituting Binance's violations described in this Count. Therefore, pursuant to Section 13(b) of the Act, 7 U.S.C. § 13c(b), Zhao is liable as a control person for Binance's violations described in this Count.

223. The acts and omissions of Zhao, Lim, and other officers, employees, or agents acting for Binance described in this Complaint were done within the scope of their office, employment, or agency with Binance. Therefore, pursuant to 7 U.S.C. § 2(a)(1)(B) and 17 C.F.R. § 1.2, Binance is liable as a principal for each act, omission, or failure of the other officers, employees, or agents acting for Binance, constituting violations of 17 C.F.R. § 166.3.

224. From July 2019 through at least January 2022 and while acting as Binance's Chief Compliance Officer, Lim willfully aided, abetted, counseled, commanded, induced, or procured the acts constituting Binance's violations described in this Count, or acted in combination or concert with any other person in any such violation, or willfully caused an act to

be done or omitted which if directly performed or omitted by Lim or another would constitute a violation described in this Count. Pursuant to 7 U.S.C. § 13c(a), Lim is therefore liable for Binance's violations described in this Count to the same extent as Binance.

COUNT VI

Violations of Regulation 42.2, 17 C.F.R. § 42.2 (2022)

Failure to Implement Customer Information Program, and Failure to Implement Know Your Customer and Anti-Money Laundering Procedures

225. Paragraphs 1 through 186 of this Complaint are re-alleged and incorporated herein by reference.

226. During the Relevant Period, Defendants Binance Holdings, Binance IE, and Binance Services, all acting as a common enterprise and doing business as Binance, and through their officers, employees, and agents, violated and are continuing to violate 17 C.F.R. § 42.2 by failing to implement a Customer Information Program, failing to implement Know-Your-Customer policies and procedures, failing to implement an Anti-Money Laundering program, failing to retain required customer information, and failing to implement procedures to determine whether a customer appears on lists of known or suspected terrorists or terrorist organizations such as those issued by OFAC.

227. Each act in violation of 17 C.F.R. § 42.2, including, but not limited to, those specifically alleged herein, is alleged as a separate and distinct violation.

228. During the Relevant Period, Zhao directly or indirectly controlled Binance, and did not act in good faith or knowingly induced, directly or indirectly, the acts constituting Binance's violations described in this Count. Therefore, pursuant to 7 U.S.C. § 13c(b), Zhao is liable as a control person for Binance's violations described in this Count.

229. The acts and omissions of Zhao, Lim, and other officers, employees, or agents acting for Binance described in this Complaint were done within the scope of their office, employment, or agency with Binance. Therefore, pursuant to 7 U.S.C. § 2(a)(1)(B) and 17 C.F.R. § 1.2, Binance is liable as a principal for each act, omission, or failure of the other officers, employees, or agents acting for Binance, constituting violations of 17 C.F.R. § 42.2.

230. From July 2019 through at least January 2022 and while acting as Binance's Chief Compliance Officer, Lim willfully aided, abetted, counseled, commanded, induced, or procured the acts constituting Binance's violations described in this Count, or acted in combination or concert with any other person in any such violation, or willfully caused an act to be done or omitted which if directly performed or omitted by Lim or another would constitute a violation described in this Count. Pursuant to 7 U.S.C. § 13c(a), Lim is therefore liable for Binance's violations described in this Count to the same extent as Binance.

COUNT VII

Violations of Regulation 1.6, 17 C.F.R. § 1.6 (2022)

Anti-Evasion

231. Paragraphs 1 through 186 of this Complaint are re-alleged and incorporated herein by reference.

232. During the Relevant Period, Defendants Zhao and Lim, as well as Defendants Binance Holdings, Binance IE, and Binance Services, all acting as a common enterprise and doing business as Binance, and through their officers, employees, and agents, violated and are continuing to violate 17 C.F.R. § 1.6 by conducting activities outside the United States, including entering into agreements, contracts, and transactions and structuring entities, to willfully evade or attempt to evade provisions of the Act and its Regulations.

233. Each act in violation of 17 C.F.R. § 1.6, including, but not limited to, those specifically alleged herein, is alleged as a separate and distinct violation.

234. During the Relevant Period, Zhao directly or indirectly controlled Binance, and did not act in good faith or knowingly induced, directly or indirectly, the acts constituting Binance's violations described in this Count. Therefore, pursuant to 7 U.S.C. § 13c(b), Zhao is liable as a control person for Binance's violations described in this Count.

235. The acts and omissions of Zhao, Lim, and other officers, employees, or agents acting for Binance described in this Complaint were done within the scope of their office, employment, or agency with Binance. Therefore, pursuant to 7 U.S.C. § 2(a)(1)(B) and 17 C.F.R. § 1.2, Binance is liable as a principal for each act, omission, or failure of the other officers, employees, or agents acting for Binance, constituting violations of 17 C.F.R. § 1.6.

236. From July 2019 through at least January 2022 and while acting as Binance's Chief Compliance Officer, Lim willfully aided, abetted, counseled, commanded, induced, or procured the acts constituting Binance's violations described in this Count, or acted in combination or concert with any other person in any such violation, or willfully caused an act to be done or omitted which if directly performed or omitted by Lim or another would constitute a violation described in this Count. Pursuant to 7 U.S.C. § 13c(a), Lim is therefore liable for Binance's violations described in this Count to the same extent as Binance.

VII. RELIEF REQUESTED

WHEREFORE, the Commission respectfully requests that the Court, as authorized by Section 6c of the Act, 7 U.S.C. § 13a-l, and pursuant to the Court's own equitable powers, enter:

A. An order finding that Defendants Binance Holdings Limited, Binance Holdings (IE) Limited, and Binance (Services) Holdings Limited, collectively doing business as Binance, and through their officers, employees, and agents, including without limitation Zhao, violated

Section 4(a) of the Act, 7 U.S.C. § 6(a) (or, in the alternative, Section 4(b) of the Act, 7 U.S.C. § 6(b), and Regulation 48.3, 17 C.F.R. 48.3 (2022)); Section 4c(b) of the Act, 7 U.S.C. § 6c(b), and Regulation 32.2, 17 C.F.R. § 32.2 (2022); Section 4d of the Act, 7 U.S.C. § 6d; Section 5h(a)(1) of the Act, 7 U.S.C. § 7b-3(1), and Regulation 37.3(a)(1), 17 C.F.R. § 37.3(a)(1) (2022); Regulation 166.3, 17 C.F.R. § 166.3 (2022); Regulation 42.2, 17 C.F.R. § 42.2 (2022); and Regulation 1.6(a), 17 C.F.R. § 1.6(a) (2022); finding that Changpeng Zhao is liable for Binance's aforementioned violations as a control person pursuant to Section 13(b) of the Act, 7 U.S.C. § 13c(b), and for violating Regulation 1.6(a); and further finding that Samuel Lim is liable for aiding and abetting Binance's aforementioned violations pursuant to Section 13(a) of the Act, 7 U.S.C. § 13c(a), and for violating Regulation 1.6(a).

B. An order of permanent injunction prohibiting Defendants and any other person or entity associated with them, from engaging in conduct described above, in violation of 7 U.S.C. §§ 6(a) (or in the alternative 6(b) and 17 C.F.R. 48.3), 6c(b), 6d, and 7b-3(1), and 17 C.F.R. §§ 1.6(a), 32.2, 37.3(a)(1), 42.2, and 166.3.

C. An order of permanent injunction prohibiting Defendants and any of their affiliates, officers, agents, employees, successors, assigns, attorneys, and persons in active concert or participation with Defendants, from directly or indirectly:

(i) trading on or subject to the rules of any registered entity (as that term is defined in Section la of the Act, 7 U.S.C. § la(40));

(ii) entering into any transactions involving "commodity interests" (as that term is defined in Regulation 1.3, 17 C.F.R. § 1.3 (2022)) and/or digital asset commodities as defined herein, for Defendants' own accounts or for any account in which they have a direct or indirect interest;

(iii) having any commodity interests and/or digital asset commodities as defined herein traded on Defendants' behalf;

(iv) controlling or directing the trading for or on behalf of any other person or entity, whether by power of attorney or otherwise, in any account involving commodity interests and/or digital asset commodities as defined herein;

(v) soliciting, receiving, or accepting any funds from any person for the purpose of purchasing or selling any commodity interests and/or digital asset commodities as defined herein;

(vi) applying for registration or claiming exemption from registration with the Commission in any capacity, and engaging in any activity requiring such registration or exemption from registration with the Commission, except as provided for in Regulation 4.14(a)(9), 17 C.F.R. § 4.14(a)(9) (2022); and

(vii) acting as a principal (as that term is defined in Regulation 3.1(a), 17 C.F.R. § 3.1(a) (2022)), agent or any other officer or employee of any person registered, exempted from registration or required to be registered with the Commission except as provided for in Regulation 4.14(a)(9);

D. An order directing Defendants and any third party transferee and/or successors thereof, to disgorge to any officer appointed or directed by the Court all benefits received including, but not limited to, trading profits, revenues, salaries, commissions, loans, or fees derived, directly or indirectly, from acts or practices which constitute violations of the Act as described herein, including pre-judgment and post-judgment interest;

E. An order directing Defendants and any successors thereof, to rescind, pursuant to such procedures as the Court may order, all contracts and agreements, whether implied or

express, entered into between, with, or among Defendants and any customer or investor whose funds were received by Defendants a result of the acts and practices that constituted violations of the Act, as described herein;

F. An order requiring Defendants to make full restitution by making whole each and every customer or investor whose funds were received or utilized by them in violation of the provisions of the Act as described herein, including pre-judgment interest;

G. An order directing Defendants to pay civil monetary penalties, to be assessed by the Court, in an amount not more than the penalty prescribed by Section 6c(d)(1) of the Act, 7 U.S.C. § 13a-1(d)(1), as adjusted for inflation pursuant to the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015, Pub. L. 114–74, tit. VII, § 701, 129 Stat. 584, 599-600, *see* Regulation 143.8, 17 C.F.R. § 143.8 (2022), for each violation of the Act, as described herein;

H. An order requiring Defendants to pay costs and fees as permitted by 28 U.S.C. §§ 1920 and 2412(a)(2); and

I. Such other and further relief as the Court deems proper.

JURY TRIAL DEMANDED

Plaintiff hereby demands a jury trial on all issues so triable.

Dated: March 27, 2023

Respectfully submitted,

Commodity Futures Trading Commission
By its attorneys:

/s/ Joseph Platt

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TAB 11

CFPB v. Nexo Financial LLC, 22-MISC-Nexo Financial LLC-0001

UNITED STATES OF AMERICA

FEDERAL RESERVE SYSTEM

CONSUMER FINANCIAL PROTECTION BUREAU

NEXO FINANCIAL LLC	2022-MISC-Nexo Financial LLC-0001

DECISION AND ORDER ON PETITION BY NEXO FINANCIAL LLC TO MODIFY CIVIL INVESTIGATIVE DEMAND

Nexo Financial LLC has petitioned the Consumer Financial Protection Bureau for an order modifying a civil investigative demand ("CID") issued to it. For the reasons set forth below, the petition is **DENIED**.

I. BACKGROUND

On December 1, 2021, the Consumer Financial Protection Bureau ("Bureau") served Nexo Financial LLC ("Nexo Financial") with a CID requiring that a representative of the company appear by videoconference for oral testimony at an investigational hearing to be held on January 5, 2022. At that time, Nexo Financial, along with its affiliates (collectively, "Nexo"), advertised a range of products, including interest-accruing accounts and lines of credit. Nexo's website highlights that the company is licensed by various state regulators to engage in consumer lending and money transmitting.[1]

Nexo Financial met and conferred with staff from the Bureau's Office of Enforcement on December 14 and 20, 2021, January 5, 2022, February 18, 2022, and March 4, 2022. In the

[1] https://nexo.io/licenses-and-registrations.

meantime, on January 20, 2022, and again on March 8, 2022, the Office of Enforcement extended the date of the investigational hearing. As of March 8, 2022, the hearing was scheduled to be conducted on April 5, 2022.

On March 14, 2022, Nexo Financial filed a petition to modify the Bureau's CID.

II. LEGAL DETERMINATION

Nexo Financial argues that the CID should be modified to exclude Nexo's "Earn Interest Product" because (according to Nexo Financial) the Bureau lacks authority over that product. In addition, as a procedural matter, Nexo Financial argues that its petition is timely even though the petition was filed more than 20 days after service of the CID and Nexo Financial did not seek or obtain an extension to file the petition.

For each of the two independent reasons set forth below, the petition is denied.

1. The Bureau has the authority to investigate whether Nexo Financial or others associated with it may have violated federal consumer financial law.

As the CID itself indicates, the Bureau issued it as part of an investigation that, as of December 1, 2021, sought to determine three related questions: (1) whether subject entities were engaged in conduct that is subject to federal consumer financial law (specifically, the Consumer Financial Protection Act and Regulation E, which implements the Electronic Fund Transfer Act); (2) whether those entities had violated the CFPA and Regulation E; and (3) whether a Bureau enforcement action would be in the public interest.

In its petition, Nexo Financial claims that the Bureau lacks the authority to investigate Nexo's Earn Interest Product. To support that contention, Nexo Financial asserts that the Securities and Exchange Commission "made patently clear in the BlockFi Order[2] that it believes

[2] *See In the Matter of BlockFi Lending LLC*, No. 3-20758 (SEC Feb. 14, 2022),

interest-bearing crypto lending products [like Nexo's Earn Interest Product] are securities." Pet. at 6. However, Nexo Financial does not contend that the SEC has determined that the Earn Interest Product is a security. Nor, for that matter, does Nexo Financial concede that the Earn Interest Product is, in fact, a security, or that Nexo's offering of the Earn Interest Product required Nexo Financial or any other Nexo entity to register with the SEC (whether as a broker, dealer, investment company, or for any other reason). Indeed, Exhibit C to Nexo Financial's petition reproduces an email that Nexo apparently sent its customers on February 8, 2022, which states, "[w]e have not filed or confidentially submitted a registration statement with the SEC for any interest-bearing products and there is no guarantee it would be declared effective." In other words, Nexo Financial is trying to avoid answering any of the Bureau's questions about the Earn Interest Product (on the theory that the product is a security subject to SEC oversight) while at the same time preserving the argument that the product is not a security subject to SEC oversight. This attempt to have it both ways dooms Nexo Financial's petition from the start.[3]

To see why, it is important to recall that the recipient of a CID[4] cannot challenge an agency investigation by preemptively contesting the facts that the agency might find, at least where the investigation is not patently outside the agency's authority. *FTC v. Ken Roberts Co.*, 276 F.3d 583, 584 (D.C. Cir. 2001) ("Unless it is patently clear that an agency lacks the

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https://www.sec.gov/litigation/admin/2022/33-11029.pdf.

[3] The Office of Enforcement engages in discussions with entities who receive CIDs, and those discussions assist the CFPB in further understanding entities' business practices. As a practical matter, the Office of Enforcement may withdraw a CID if it learns that a relevant activity is outside the Bureau's authority or if it uncovers some other reason that counsels against pursuing the investigation. Here, however, Nexo Financial has not demonstrated any basis to withdraw the CID issued to it.

[4] The courts "have treated CIDs as a form of administrative subpoena." *See CFPB v. Accrediting Council for Indep. Colleges & Sch.*, 854 F.3d 683, 688 (D.C. Cir. 2017).

jurisdiction that it seeks to assert, an investigative subpoena will be enforced."). The Supreme Court has "consistently reaffirmed" the principle that "courts should not refuse to enforce an administrative subpoena when confronted by a fact-based claim regarding coverage or compliance with the law." *EEOC v. Karuk Tribe Hous. Auth.*, 260 F.3d 1071, 1076 (9th Cir. 2001) (citing *United States v. Powell*, 379 U.S. 48, 57-58 (1964)); *CFPB v. Harbor Portfolio Advisors, LLC*, 2017 WL 631914, at *3 (E.D. Mich. Feb. 16, 2017) ("Whether Respondents' transactions *actually* involve 'credit' is not at issue, and it would be premature for the Court to decide that question at this stage.").

Here, the unsettled facts related to the Earn Interest Product make it impossible to tell whether any of Nexo Financial's conduct in connection with the Earn Interest Product might be subject to an exclusion from the Bureau's authority under the CFPA or to an exemption to Regulation E.

First, take the CFPA. Under 12 U.S.C. § 5517(i)(1), "the Bureau shall have no authority to exercise any power to enforce [the CFPA] with respect to a person regulated by the Commission." The phrase "person regulated by the Commission" is a defined term. *Id.* § 5481(21). It means, among other things, a person who is "a broker or dealer that is required to be registered under the Securities Exchange Act of 1934," an investment company that is required to be registered under the Investment Company Act of 1940, and "any employee, agent, or contractor acting on behalf of, registered with, or providing services to" such a regulated person, "but only to the extent that [the regulated person], or the employee, agent, or contractor of such person, acts in a regulated capacity." *Id.* § 5481(21)(A), (C), (L).

As noted above, Nexo Financial does not claim that it (or any other Nexo entity) was required to be registered under the Exchange Act, the Investment Company Act, or any of the

other enumerated securities law in § 5481(21)(A)-(K). Instead, it posits that the SEC likely believes that Nexo's Earn Interest product is a security while studiously avoiding stating that Nexo Financial agrees with that assumed assessment or that Nexo Financial (or any other Nexo entity) was required to register with the SEC. At this point in the Bureau's investigation, it is too early to tell whether Nexo Financial (or any other Nexo entity) was required to be registered with the SEC under any of the enumerated securities laws in § 5481(21)(A)-(K) and, if so, whether and to what extent Nexo Financial was acting in a regulated capacity with respect to the Earn Interest product.

Next, consider Regulation E, which generally applies to "electronic fund transfers." Under 12 C.F.R. § 1005.3(c)(4), the term "electronic fund transfer" does not include "[a]ny transfer of funds the primary purpose of which is the purchase or sale of a security …, if the security … is … [r]egulated by the [SEC]" or "[p]urchased or sold through a broker-dealer regulated by the [SEC]." The Official Interpretations of Regulation E provide two examples of transfers to which this exemption does not apply: (1) transfers involving "[a] debit card or other access device that accesses a securities … account such as a money market mutual fund and that the consumer uses for purchasing goods or services or for obtaining cash" and (2) transfers involving "[p]ayment of interest or dividends into the consumer's account (for example, from a brokerage firm or from a Federal Reserve Bank for government securities)." 12 C.F.R. pt. 1005, Supp. I, cmt. 3(c)(4)-3.

Here, of course, Nexo Financial is unwilling to concede that the Earn Interest Product is a security and does not assert that it (or any other Nexo entity) was a broker-dealer regulated by the SEC. As a result, it is too early to determine whether any of the fund transfers offered or provided by Nexo Financial in connection with the Earn Interest Product were subject to

Regulation E's exemption for securities transfers, let alone to conclude that every such transfer is exempt (as would be necessary to demonstrate that investigation of the Earn Interest Product is patently outside the Bureau's authority).

Accordingly, Nexo Financial's petition fails to demonstrate that the Bureau lacks authority to investigate its Earn Interest product or any other product. The petition is therefore denied.

2. The petition is untimely because Nexo Financial filed it more than 20 days after service of the CID and without obtaining an extension.

The CFPA and the Bureau's implementing regulations set forth a clear deadline for petitioning to modify or set aside a CID and a clear process for obtaining extensions of time. Nexo Financial ignored both. Its petition is therefore denied for the independent reason that it is untimely.

Under 12 U.S.C. § 5562(f) and 12 C.F.R. 1080.6, the deadline for responding to a CID is 20 calendar days from service of the CID or any time before the return date on the CID, whichever is earlier. Here, because the CID was served on December 1, 2021, and the return date was extended until April 5, 2022, the petition was due on December 21, 2021. By statute, this deadline can be extended "as may be prescribed in writing, subsequent to service, by any Bureau investigator named in the demand." 12 U.S.C. § 5562(f). The Bureau's rules further specify that "[t]he Assistant Director of the Office of Enforcement and the Deputy Assistant Directors of the Office of Enforcement are authorized to rule upon requests for extensions of time within which to file such petitions" and that "[r]equests for extensions of time are disfavored." 12 C.F.R. § 1080.6(e)(2). Nexo Financial did not seek an extension pursuant to these rules, yet did not file its petition until March 14, 2021, nearly three months after the deadline.

Nevertheless, Nexo Financial contends, at 5, that its petition was timely because the deadline was "effectively tolled" by its ongoing efforts to meet and confer with the Office of Enforcement. Accordingly, Nexo Financial contends that it had ten days from its last meet and confer to file the petition.[5] This theory is inconsistent with the statutory and regulatory provisions governing extensions, which specify that extensions are to be granted "in writing," by an Assistant Enforcement Director or Deputy Assistant Enforcement Director, and that requests for extensions are "disfavored." On Nexo Financial's theory, extensions are implicitly provided by Enforcement staff any (and every) time the parties continue to meet and confer about a CID more than 10 days after the CID is received. This is not what the statute or the rules say. Nexo Financial's petition is untimely and is denied on that independent ground.

[5] Nexo Financial is wrong to suggest, at 5, that the "rules implicitly provide for 10 calendar days between the meet and confer process and the time to file a petition." Indeed, the rules contemplate that in some cases (i.e., where the CID's return date is less than 20 days from the service of the CID) there will be fewer than 10 days between the meet-and-confer deadline and the petition deadline.

III. CONCLUSION

For the foregoing reasons, the petition to modify the CID is **DENIED**. Nexo Financial is directed to appear for oral testimony on December 19, 2022. Nexo Financial is welcome to engage in discussions with Bureau staff about another date for its appearance that may be acceptable to the Assistant Director or Deputy Assistant Director of the Office of Enforcement.

IT IS SO ORDERED.

Dated: November 22, 2022

Rohit Chopra
Rohit Chopra
Director

TAB 12

SEC v. Blockvest, LLC, 18-CV-2287 (S.D. Cal.) Doc. No. 61

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. BLOCKVEST, LLC and REGINALD BUDDY RINGGOLD, III a/k/a RASOOL ABDUL RAHIM EL, Defendants.	Case No.: 18CV2287-GPB(BLM) **ORDER GRANTING PLAINTIFF'S MOTION FOR PARTIAL RECONSIDERATION** **[Dkt. No. 44.]**

Before the Court is Plaintiff's motion for partial reconsideration of the Court's order denying preliminary injunction. (Dkt. No. 44.) Defendants filed an opposition, (Dkt. No. 53), and Plaintiff replied. (Dkt. No. 55.) A hearing was held on February 8, 2019. (Dkt. No. 58.) Amy Longo, Esq. and Brent Wilner, Esq. appeared on behalf of Plaintiff Securities Exchange Commission and Stanley Morris, Esq. and Brian Corrigan, Esq. appeared on behalf of Defendants. (Dkt. No. 58.) Based on the reasoning below, and the arguments at the hearing, the Court GRANTS Plaintiff's motion for partial reconsideration.

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Procedural Background

On October 3, 2018, Plaintiff Securities and Exchange Commission ("SEC" or "Plaintiff") filed a Complaint against Defendants Blockvest, LLC and Reginald Buddy Ringgold, III a/k/a Rasool Abdul Rahim El alleging violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act') and Rule 10b-5(b); violations under Section 10(b) of the Exchange Act and Rule 10b-5(a) and Rule 10b-5(c); fraud in violation of Section 17(a)(2) of the Securities Act of 1933 ("Securities Act"), fraud in violation of Sections 17(a)(1) and 17(a)(3) of the Securities Act; and violations of Sections 5(a) and 5(c) of the Securities Act for the offer and sale of unregistered securities. (Dkt. No. 1, Compl.) Plaintiff also concurrently filed an ex parte motion for temporary restraining order seeking to halt Defendants' fraudulent conduct and freezing their assets, prohibiting the destruction of documents, seeking expedited discovery and an accounting of Defendants' assets. (Dkt. No. 3.) On October 5, 2018, the Court granted Plaintiff's ex parte motion for temporary restraining order. (Dkt. Nos. 5, 6.) In compliance with the temporary restraining order, Defendants filed Ringgold's Declaration of Accounting on October 26, 2018, and a First Supplemental Declaration of Ringgold on November 2, 2018. (Dkt. Nos. 18, 21.) Defendants also filed a response to the order to show cause on November 2, 2018. (Dkt. Nos. 23, 24, 25.) On November 7, 2018, Plaintiff filed a reply. (Dkt. Nos. 27, 28.) A hearing on the order to show cause was held on November 16, 2018, (Dkt. No. 37), and on November 27, 2018, the Court denied a preliminary injunction. (Dkt. No. 41.)

In this fully briefed motion, Plaintiff moves for partial reconsideration pursuant to Federal Rule of Civil Procedure 59(e) of the Court's denial of a preliminary injunction against Defendants for future violations of Section 17(a) of the Securities Act and seeks an order preliminarily enjoining Defendants from violating Section 17(a). (Dkt. Nos. 44, 53, 55.)

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Factual Background[1]

Defendant Reginald Buddy Ringgold, III ("Ringgold"), is the chairman and founder of Defendant Blockvest, LLC ("Blockvest") (collectively "Defendants"), a Wyoming limited liability company that was set up to exchange cryptocurrencies but has never become operational. (Dkt. No. 24, Ringgold Decl. ¶ 4.) Blockvest Investment Group, LLC owns 100% of Blockvest LLC. (Id.) Ringgold owns 51% of the membership interests of Blockvest Investment Group, LLC, 9% are unissued, 20% is owned by Michael Shepperd, and the remaining 20% is owned by Ringgold's mother. (Id.)

The complaint alleges that Defendants have been offering and selling unregistered securities in the form of digital assets called BLV's. It involves an initial coin offering ("ICO"), which is a fundraising event where an entity offers participants a unique digital "coin" or "token" or "digital asset" in exchange for consideration, often in the form of virtual currency—most commonly Bitcoin and Ether—or fiat currency. (Dkt. No. 1, Compl. ¶ 18.) The tokens are issued on a "blockchain" or cryptographically secured ledger. (Id. ¶ 19.) The token may entitle its holders to certain rights related to a venture underlying the ICO, such as rights to profits, shares of assets, rights to use certain services provided by the issuer, and/or voting rights. (Id. ¶ 21.) These tokens may also be listed on online trading platforms, often called virtual currency exchanges, and tradable for virtual or fiat currencies. (Id.) ICOs are typically announced and promoted through online channels and issuers usually release a "Whitepaper" describing the project and the terms of the ICO. (Id. ¶ 22.) To participate, investors are generally required to transfer funds (often virtual currency) to the issuer's address, online wallet, or other account. (Id.) After the completion of the ICO, the issuer will distribute its unique "tokens" to the participants' unique address on the blockchain. (Id.)

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[1] The facts are taken from the Court's order on preliminary injunction. (Dkt. No. 41.)

Relying on Blockvest's website and Whitepaper posted online, the SEC claims that Blockvest conducted pre-sales of BLVs in March 2018. According to the Whitepaper, the BLVs are being sold in several stages: 1) a private sale (with a 50% bonus) that ran through April 30, 2018; 2), a "pre-sale" (with a 20% bonus) from July 1, 2018 through October 6, 2018; and 3) the $100 million ICO launch on December 1, 2018. (Dkt. No. 1, Compl. ¶ 30; Dkt. No. 3-12, Wilner Decl., Ex. 10 at p. 93; Dkt. No. 3-13, Wilner Decl., Ex. 11 at p. 127.) On its Twitter account, on May 8, 2018, Blockvest claimed it raised $2.5 million in 7 days, (Dkt. No. 3-19, Ex. 44 at p. 479), and by September 17, 2018, the Blockvest website stated that 18% of the tokens being offered or around 9 million token were sold. (Dkt. No. 3-12, Wilner Decl., Ex. 10 at p. 96.) Blockvest purports to be the "First Licensed and Regulated Tokenized Crypto Currency Exchange & Index Fund based in the US". (Dkt. No. 3-23, Suppl. Wilner Decl., Ex. 1 at p. 3.)

According to the SEC, Blockvest and Ringgold falsely claim their ICO has been "registered" and "approved" by the SEC and uses the SEC's seal on the website. (Dkt. No. 3-18, Wilner Decl., Ex. 41 at p. 416; Dkt. No. 3-23, Suppl. Wilner Decl., Ex. 1 at p. 2.) But the SEC has not approved, authorized or endorsed Defendants, their entities or their ICO. They also falsely claim their ICO has been approved or endorsed by the Commodity Futures Trading Commission ("CFTC") and the National Futures Association ("NFA") by utilizing their logos and seals and stating "Under the helpful eye of the CFTC and the NFA . . . the Fund will be managed by Blockvest Investment Group, LLP, a commodity pool operator registered with the Commodity Futures Trading Commission and a member of the National Futures Association. . . ." (Dkt. No. 3-23, Suppl. Wilner Decl., Ex. 1 at p.1; id. at p. 2.) But the CFTC and NFA have not approved the ICO. Defendants further falsely assert they are "partnered" with and "audited by" Deloitte Touche Tohmatsu Limited ("Deloitte) but that is also not true. (Dkt. No. 3-3, Barnes Decl. ¶ 7.) In order to create legitimacy and an impression that their investment is safe, Defendants also created a fictitious regulatory agency, the Blockchain Exchange Commission ("BEC"), creating its own fake government seal, logo, and mission

statement that are nearly identical to the SEC's seal, logo and mission statement. (Dkt. No. 3-13, Wilner Decl., Exs. 13-19 at p. 149-67.) Moreover, it falsely lists BEC's "office" as the same address as the SEC's headquarters. (Dkt. No. 3-13, Wilner Decl., Ex. 14.)

In response, Ringgold asserts that Blockvest has never sold any tokens to the public and has only one investor, Rosegold Investments LLP, ("Rosegold") which is run by him and in which he has invested more than $175,000 of his own money. (Dkt. No. 24, Ringgold Decl. ¶ 5.) Blockvest utilized BLV tokens during the testing and development phase and a total of 32 partner testers were involved. (Id.)

During this testing, 32 testers put a total of less than $10,000 of Bitcoin and Ethereum onto the Blockvest Exchange where half of it remains today. (Id. ¶ 6.) The other half was used to pay transactional fees to unknown and unrelated third parties. (Id. ¶ 7.) No BLV tokens were ever released from the Blockvest platform to the 32 testing participants. (Id. ¶ 6.) The BLV tokens were only designed for testing the platform and the testers would not and could not keep or remove BLV tokens from the Blockvest Exchange. (Id.) Their plan was to eventually issue a "new utility Token BLVX on the NEM Blockchain for exclusive use on the BlockVest Exchange." (Id.) Ringgold never received any money from the sale of BLV tokens. (Id. ¶ 7.) The deposits are from digital wallet addresses and individuals that are not easily identifiable, but Ringgold believes that only affiliated persons would have deposited Bitcoin or Ethereum on the exchange and received nothing without complaining. (Id.) The Blockvest Exchange platform was never open for business. (Id.)

At his deposition, Ringgold testified he knows the identity of the 32 investors. (Dkt. No. 27-18, Brown Decl., Ex. 17, Ringgold Depo. at 132:15-20.) He indicated it was clear to the 32 testers that they were testing the platform so Defendants did not obtain any earnings statements from them. (Id. at 132:21-133:4.) Ringgold explains that the 32 investor were vetted and chosen based on Defendants' prior relationship with them. (Id. at 133:11-18; 135:1-23.) During the vetting process, Defendants collected

their name, email, address and their level of sophistication. (Id. at 135:1-6.) They held several conferences and a webinar where Ringgold explained his requirements for the group of test investors. (Id. at 136:3-18.)

Ringgold is also a principal in Master Investment Group and a trustee of Rosegold Investment Trust, partners of Rosegold Investment, LLP, a Delaware limited liability partnership formed in April 2017. (Dkt. No. 24, Ringgold Decl. ¶ 10.) Rosegold manages Blockvest and finances Blockvest's activities, as Blockvest, itself, has no bank accounts or assets, other than the work-in-progress development of a cryptocurrency exchange of unknown value. (Id.) The Rosegold bank account was opened in September 2017. (Id.)

Ringgold personally invested over $175,000 in Rosegold and Michael Sheppard, Blockvest's Chief Financial Officer, invested about $20,000. (Id. ¶ 11.) Other investors in Rosegold are Ringgold's and Sheppard's friends and family. (Id.) At times, these investors loaned Ringgold or Sheppard money personally and they in turn, invested the money into Rosegold as their personal investment. (Id.) Seventeen individuals have loaned or invested money in Rosegold Investments. (Id. ¶ 12; id., Ex. 2.) Nine of these individuals confirm they did not buy BLV tokens or rely on any of the representations the SEC has alleged were false.[2] (Id.) His friends and family, as well as Mike Sheppard's friends and family who invested in Rosegold did not care what they were investing in because they trusted them based on their long-time familial and friend relationship. (Dkt. No. 27-18, Brown Decl., Ex. 17, Ringgold Depo. at 86:3-6; 87:4-9; 89:1-3.) Ringgold claims he never received anything of value from the offer or sale of BLV tokens to anyone. (Dkt. No. 24, Ringgold Decl. ¶ 13.)

[2] Of the 17 individuals, nine individuals signed declarations asserting that they did not buy BLV tokens or rely on any representations by Defendants that the SEC asserts were false. (Dkt. No. 24, Ringgold Decl., Ex. 2.) The SEC points out that the remaining eight individuals wrote "Blockvest" and/or "coins" on their checks.

Ringgold recognizes that mistakes were made but no representations or omissions were made in connection with the sale and purchase of securities. (Id. ¶ 14.) They were in the early stages of development as the Chief Compliance Officer had not yet reviewed all the materials. (Id. ¶ 16.) Ringgold states it was his intention to comply with "every possible regulation and regulatory agency." (Id.) Currently, he has ceased all efforts to proceed with the ICO and agrees not to proceed with an ICO until he gives SEC's counsel 30 days' notice. (Id. ¶ 17.)

Discussion

A. Legal Standard on Motion for Reconsideration

Federal Rule of Civil Procedure 59(e) provides for the filing of a motion to alter or amend a judgment. Fed. R. Civ. P. 59(e). A motion for reconsideration, under Federal Rule of Civil Procedure 59(e), is "appropriate if the district court (1) is presented with newly discovered evidence; (2) committed clear error or the initial decision was manifestly unjust, or (3) if there is an intervening change in controlling law." Sch.Dist. No. 1J, Multnomah County, Or., v. ACandS, Inc., 5 F.3d 1255, 1263 (9th Cir. 1993); see also Ybarra v. McDaniel, 656 F.3d 984, 998 (9th Cir. 2011). "Clear error occurs when 'the reviewing court on the entire record is left with the definite and firm conviction that a mistake has been committed.'" Smith v. Clark Cnty. Sch. Dist., 727 F.3d 950, 955 (9th Cir. 2013) (quoting United States v. U.S. Gypsum Co., 333 U.S. 364, 395 (1948)).

B. Preliminary Injunction

The party moving for a preliminary injunction bears the burden to demonstrate the factors justifying relief. Granny Goose Foods, Inc. v. Brotherhood of Teamsters & Auto Truck Drivers, 415 U.S. 423, 441 (1974). Because the SEC is a governmental agency acting as a "statutory guardian charged with safeguarding the public interest in enforcing the securities laws", SEC v. Mgmt. Dynamics, Inc., 515 F.2d 801, 808 (2d Cir. 1975), courts have adopted a two part factor test requiring the SEC to show "(1) a prima facie case of previous violations of federal securities laws, and (2) a reasonable likelihood that

the wrong will be repeated." SEC v. Unique Fin. Concepts, Inc., 196 F.3d 1195, 1199 n. 2 (11th Cir. 1999) (citing Mgmt. Dynamics, Inc., 515 F.2d at 806–07; SEC v. Manor Nursing Ctrs, Inc., 458 F.2d 1082, 1100 (2d Cir. 1972)); see also SEC v. Schooler, 902 F. Supp. 2d 1341, 1345 (S.D. Cal. 2012) (using the two-part standard when determining whether to issue a preliminary injunction requested by the SEC); SEC v. Capital Cove Bancorp LLC, SACV 15-980-JLS(JCx), 2015 WL 9704076, at *5 (C.D. Cal. Sept. 1, 2015) (same).

"The grant of a preliminary injunction is the exercise of a very far reaching power never to be indulged in except in a case clearly warranting it. . . . [O]n application for preliminary injunction the court is not bound to decide doubtful and difficult questions of law or disputed questions of fact." Dymo Indus., Inc. v. TapePrinter, Inc., 326 F.2d 141, 143 (9th Cir. 1964) (citation omitted); see also Mayview Corp. v. Rodstein, 480 F.2d 714, 719 (9th Cir. 1973) (reversing grant of preliminary injunction based on existence of disputed factual issues).

Plaintiff moves for partial reconsideration arguing that the Court committed clear error on both prongs to support a preliminary injunction on the Section 17(a) violations. First it argues that it was error for the Court to require the SEC to prove that an investment is a security based solely on the beliefs of some individual investors, rather than the objective nature of the investment being offered to the public. Second, the Court also erred on the second factor based on Defendants' promise not to commit any future securities fraud. Defendants disagree with Plaintiff's arguments. For the reasons that follow, the Court finds reconsideration is warranted based upon a prima facie showing of Defendants' past securities violation and newly developed evidence which supports the conclusion that there is a reasonable likelihood of future violations.

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C. Prima Facie Case of Past Securities Violations

Plaintiff alleges Defendants violated Sections 17(a)(1), (2), and (3) of the Securities Act.[3] (Dkt. No. 1, Compl.) Section 2(a)(1) of the Securities Act defines "security" as *inter alia*, a "note, stock, treasury stock, bond, [or] investment contract." 15 U.S.C. § 77b(a)(1). Congress defined "security" to be "sufficiently broad to encompass virtually any instrument that might be sold as an investment" but did not "intend to provide a broad federal remedy for all fraud." Reves v. Ernst & Young, 494 U.S. 45, 61 (1990) (internal quotations omitted). Courts should look not to the form but to the "economic realities of the transaction." United Hous. Fdn. v. Forman, 421 U.S. 837, 838 (1975).

In Howey, the Court defined whether an investment contract is a security under the Securities Act and held that an investment contract is "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946). The Court noted that the Securities Act prohibits not only the sale but also the offer of an unregistered, non-exempt security so the fact that purchasers choose not to accept the full offer is not relevant. Id. at 300-01. Although Howey's

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[3] Section 17(a) provides,

> It shall be unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q.

holding was limited to "investment contracts," the Supreme Court later found that this test "embodies the essential attributes that run through all of the Court's decisions defining a security." Forman, 421 U.S. at 852; but see Reves, 494 U.S. at 64 (establishing approach to determine whether a "note" is a "security" and rejecting circuit court's analysis of note under Howey test as the instrument in Howey being an "entirely different variety of instrument").

Howey's three-part test requires "(1) an investment of money (2) in a common enterprise (3) with an expectation of profits produced by the efforts of others." SEC v. Rubera, 350 F.3d 1084, 1090 (9th Cir. 2003) (internal quotation marks omitted); SEC v. Shavers, Case No. 13cv416, 2014 WL 12622292, at *6 (E.D. Texas Aug. 26, 2014) (district court found investment in Bitcoin Savings and Trust to be an investment contract under Howey). The Howey test is an "objective inquiry into the character of the instrument or transaction offered based on what the purchasers were 'led to expect.'" Warfield v. Alaniz, 569 F.3d 1015, 1021 (9th Cir. 2009).

The Court agrees with the SEC that the Howey test is unquestionably an objective one. However, the Court disputes the SEC's assertion that the Court applied a subjective test so as to require the SEC to demonstrate a security "solely on the beliefs of some individual investors, rather than on the objective nature of the investment being offered to the public . . . ." and for it to show what specific investors relied on before they purchased the test BLV tokens. (Dkt. No. 44-1 at 6, 15.) Instead, the Court, relying on Ninth Circuit authority, recognized it was required to objectively inquire into the "terms of promotional materials, information, economic inducements or oral representations at the seminars", (Dkt. No. 41 at 13), or in other words, an inquiry into the "character of the instrument or transaction offered" to the "purchasers." See Warfield, 569 F.3d at 1021. However, because there were disputed factual issues as to the nature of the investment being offered to the alleged investors, the Court denied the preliminary injunction as to these purchasers. See Mayview Corp., 480 F.2d at 719 (reversing preliminary injunction based on existence of disputed factual issues).

At the beginning of this litigation, the SEC requested a TRO premised upon Defendants' alleged offer and sale of unregistered securities. In granting Plaintiff's *ex parte* TRO application without notice to Defendants, the Court determined that the SEC had presented a prima facie showing based on Defendants' marketing and advertising through their websites and social media posts that BLV tokens were "securities." (Dkt. No. 5 at 8-9.) Relying on Defendants' postings on the internet, the SEC asserted that Blockvest raised more than $2.5 million from investors, there was a "common enterprise" because Blockvest claimed that the funds raised will be pooled and there would be a profit sharing formula. (Id.) Finally, as described on their website and Whitepaper, the investors in Blockvest would be passive as they would depend entirely on Defendants' efforts. (Id.)

After the TRO was granted, Defendants, in their opposition to the order to show cause, presented evidence which contradicted the SEC claim that Defendants' raised more than $2.5 million from investors. Defendants explained that they did not raise $2.5 million from the public but instead the $2.5 million was based on a transaction with David Drake which collapsed. (Dkt. No. 24, Ringgold Decl. ¶ 15.) Ringgold asserted he had not sold any BLV tokens to the public but instead used the BLV tokens for purposes of testing during the development phase. (Id. ¶ 5.) During this testing phase, 32 testers put a total of less than $10,000 of Bitcoin and Ethereum onto the Blockvest Exchange and no tokens were released to the 32 testing participants. (Id. ¶ 6.) At his deposition, Ringgold testified he knows the identity of the 32 investors. (Dkt. No. 27-18, Brown Decl., Ex. 17, Ringgold Depo. at 132:15-20.) He indicated it was clear to the 32 testers that they were testing the platform so Defendants did not obtain any earnings statements from them. (Id. at 132:21-133:4.) Ringgold explained that the 32 investor were vetted and chosen based on Defendants' prior relationship with them. (Id. at 133:11-18; 135:1-23.) During the vetting process, Defendants collected their name, email, address and their level of sophistication. (Id. at 135:1-6.) They held several conferences and a

webinar where Ringgold explained his requirements for the group of test investors. (Id. at 136:3-18.)

As to the 17 individual investors in Rosegold, Ringgold stated they were his and Sheppard's friends and family. (Dkt. No. 24, Ringgold Decl. ¶ 11.) They loaned money to Ringgold and Sheppard personally and they in turn, invested the money into Rosegold as Ringgold and Sheppard's personal investment. (Id.) Their friends and family who invested in Rosegold did not care what they were investing in because they trusted them based on their long-time familial and friend relationship. (Dkt. No. 27-18, Brown Decl., Ex. 17, Ringgold Depo. at 86:3-6; 87:4-9; 89:1-3.) Most of these individuals confirm that they did not buy BLV tokens or rely on any representations that SEC has alleged were false. (Dkt. No. 24, Ringgold Decl. ¶ 12, Ex. 2.) Therefore, Defendants argued the BLV tokens "purchased" by the 32 test investors were not "securities" and 17 individuals who invested in Rosegold did not purchase "securities."

Despite Defendants having raised disputed facts as to what was offered to the 32 test investors and 17 individual investors in Rosegold, in reply, the SEC repeated its argument that Defendants sold "securities" to them. The SEC argued that "defendants' own evidence confirms that investors provided funds to Blockvest in exchange for anticipated BLV tokens." (Dkt. No. 27 at 3.) The SEC's argument was premised on the offer and/or sale of the BLV tokens to the 32 test investors as well as the 17 individuals who invested in Rosegold. Because Defendants' facts challenged the SEC's prima facie showing on its TRO on whether a "security" was offered to the alleged "investors," the Court denied the preliminary injunction. (Dkt. No. 41 at 9-15.)

The cases cited by the Court as well as the SEC support the Court's ruling as it relates to the offer to the alleged "investors." In determining whether a transaction constituted a "security" based on an offer and/or sale to investors, the Ninth Circuit looks to the specific promotional materials presented to the "investors." In Warfield, the court had to determine whether a Foundation's charitable gift annuities were investment contracts under federal securities law. The Foundation had raised $55 million dollars

from the sale of more than 400 charitable gift annuities. Warfield, 569 F.3d at 1018. The defendants argued that there was no investment of money because they lacked the intent to realize a financial gain and were motivated solely to make charitable contributions. The court noted that the subjective intent of the purchasers may have some bearing but Howey is an objective inquiry into the character of the instrument or transaction based on what the purchasers were "led to expect." Id. at 1021. This requires an inquiry into what the purchasers were offered or promised. Id. (courts frequently examine promotional material associated with the transaction); see SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 352–53 (1943) ("The test [for determining whether an instrument is a security] . . . is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.").

As explained in Hocking, before applying the Howey test, "we must determine what exactly [the defendant] offered to [the plaintiff]." Hocking v. Dubois, 885 F.2d 1449, 1457 (9th Cir. 1989) (concerning sale of real estate). The Ninth Circuit in Hocking explained, "[c]haracterization of the inducement cannot be accomplished without a thorough examination of the representations made by the defendants as the basis of the sale. Promotional materials, merchandising approaches, oral assurances and contractual agreements were considered in testing the nature of the product in virtually every relevant investment contract case." Id. (quoting Aldrich v. McCulloch Props., Inc., 627 F.2d 1036, 1039-40 (10th Cir. 1980)).

Similarly, in this case, based on the SEC's primary argument, the Court was required to look at all that was offered or promised to the 32 test investors and 17 individual investors in Rosegold related to the BLV tokens. As to the 32 test investors, Ringgold testified that he knew them all and made oral presentations to them at seminars to explain the test tokens and provided declarations from nine of the test investors indicating they did not intend to make an investment when it tested the Blockvest exchange platform. (Dkt. No. 32, Ringgold Decl. ¶ 28; Dkt. No. 32-8.) As to the 17 individual investors, Ringgold stated that they made personal loans to him and Sheppard,

which they, in turn, invested into Rosegold as their personal investment. (Dkt. No. 24, Ringgold Decl. ¶ 12.) Contrary to the SEC's argument, the Court did not require that the SEC prove the subjective beliefs of the alleged investors. Instead, disputed issues of fact precluded the issuance of a preliminary injunction. The Court denies Plaintiff's motion for reconsideration as to the offers or promises made to the 32 test investors and 17 individual investors.

The SEC provided a separate theory to support its request for a preliminary injunction. The SEC alleged, in the alternative, that the promotional materials presented on Defendants' website, the Whitepaper posted online and social media accounts concerning the ICO of the BLV token constitute an "offer" of unregistered "securities," that contain materially false statements and thus, constitute violations of Section 17(a). (Dkt. No. 3-1 at 25, No. 27 at 10.) Defendants oppose the reconsideration motion arguing that the term "offer" requires a manifestation of intent to be bound which the SEC failed to demonstrate. (Dkt. No. 53 at 9.) The Court did not directly address this alternative theory in its original order and based upon the additional submitted briefing concludes that Defendants made an "offer" of unregistered securities which violated Section 17(a).

Section 17(a) applies to the "offer" or "sale" of securities. 15 U.S.C. § 77q. A violation of Section 17(a) does not require a completed sale of securities. See SEC v. American Commodity Exch., 546 F.2d 1361, 1366 (10th Cir. 1976) ("actual sales [are] not essential" for liability to attach under § 17(a) and § 10(b)); S.E.C. v. Tambone, 550 F.3d 106, 122 (1st Cir. 2008) (noting that "because section 17(a) applies to both sales and offers to sell securities, the SEC need not base its claim of liability on any completed transaction at all").

The Court first considers the Howey factors to consider whether Defendants' promotion of the BLV token on their website and the Whitepaper constitutes a "security." On the first "investment of money" prong, Defendants' website and Whitepaper invited or enticed potential investors to provide digital or other currency in exchange for BLV

tokens. (Dkt. No. 3-12, Wilner Decl., Ex. 10; Dkt. No. 3-13, Wilner Decl., Ex. 11.) This includes having a "Buy Now" button. (Dkt. No. 3-23, Suppl. Wilner Decl., Ex. 1 at p. 4.) An "investment of money" can take the form of "goods and services", Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 560 n. 12 (1979) ("This is not to say that a person's 'investment,' in order to meet the definition of an investment contract, must take the form of cash only, rather than of goods and services"); or "exchange of value." Hocking, 885 F.2d at 1471. Defendants' website and their Whitepaper's invitation to potential investors to provide digital currency in return for BLV tokens satisfies the first "investment of money" prong.

Here, the website promoted a "common enterprise" because Blockvest claimed that the funds raised will be pooled and there would be a profit sharing formula. See Hocking, 885 F.2d at 1459 ("The participants pool their assets; they give up any claim to profits or losses attributable to their particular investments in return for a pro rata share of the profits of the enterprise; and they make their collective fortunes dependent on the success of a single common enterprise."). Specifically, the Whitepaper stated that "[a]s a Blockvest token holder, your Blockvest will generate a pro-rated share of 50% of the profit generated quarterly as well as fees for processing transactions." (Dkt. No. 3-13, Wilner Decl., Ex. 11, p. 126.) The second Howey factor has been met.

Finally, as described on the website and Whitepaper, the investors in Blockvest would be "passive" investors and the BLV tokens would generate "passive income." (Dtk. No. 3-13, Wilner Decl., Ex. 11 at p. 126, 127); see Forman, 421 U.S. at 852 (third prong is "premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others"). In conclusion, the Court determines that the SEC has demonstrated that the promotion of the ICO of the BLV token was a "security" and satisfies the Howey test.

Next, the Court determines whether there was an "offer" of the BLV tokens subject to Section 17(a). The Securities Act defines "offer" to "include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value."

15 U.S.C. § 77b(a)(3). Section 17(a) is "intended to cover any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading." United States v. Naftalin, 441 U.S. 768, 778 (1979). In Naftalin, the Court found that the statutory phrase, "in the offer or sale of any securities," was intended to be "define[d] broadly" and is "expansive enough to encompass the entire selling process, including the seller/agent transaction." Id. at 773; see Rubin v. United States, 449 U.S. 424, 431 (1981) (noting that section 17(a) was enacted "to protect against fraud and promote the free flow of information in the public dissemination of securities" and holding that pledge of shares of stock constitutes an "offer" or "sale" of a security).

Further, the term "offer" in securities law has a "different and far broader" meaning than contract law. Hocking, 885 F.2d at 1457-58; SEC v. Cavanagh, 155 F.3d 129, 135 (2d Cir. 1998) (the definition of "offer" under 15 U.S.C. § 77b(a)(3) "extends beyond the common law contract concept of an offer" and covers the negotiations); SEC v. Comm. Inv. & Dev. Corp. of Fla., 373 F. Supp. 1153, 1164 (S.D. Fla. 1974) ("the import of the August 10, 1971 letter was to solicit CIDC shareholders to offer to buy part of the proposed public offering, and to encourage CIDC shareholders to solicit non-shareholders to buy CIDC stock. The letter constituted an 'offer to sell' within the meaning of the Securities Act.").

In Hocking, an en banc panel of the Ninth Circuit held there were genuine issues of material fact whether the sale of a condominium and a rental pool arrangement by a real estate broker constituted a "security" under the federal securities laws. Hocking, 885 F.2d at 1455. The plaintiff purchased a unit in a condominium complex in Hawaii from the defendant real estate broker who sold the property. Id. at 1451. The offer of the condominium unit also included the availability of a rental pool arrangement ("RPA") where the broker told the plaintiff that the average rental of the unit was $100 a day. Id. at 1452. While the broker did not require the plaintiff to participate in the RPA, the plaintiff testified that he would not have purchased the condominium if there was no

RPA. Id. 1453. The plaintiff entered into an agreement to purchase a unit from a prior owner and entered into several agreements with Hotel Corporation of the Pacific ("HCP) regarding the condominium's rental. He signed a rental management agreement (RMA") appointing HCP as the exclusive agent to manage the condominium; an Individual Agency Rental Agreement for Pooled Operation, the RPA, which placed the unit in HCP's rental pool; and he also subsequently signed an addendum to the RPA. Id. at 1453.

"In attempting to determine whether a scheme involves a security, the inquiry is not limited to the contract or other written instrument." Id. at 1457. The panel looked at the package that was offered to the plaintiff and held that there was a fact issue where Hocking had "put forward numerous facts concerning whether the condominium sale and rental agreements were presented to him as parts of one transaction." Id. at 1458. In its defense, the defendant argued that while the broker offered the plaintiff the condominium, the broker could not "offer" the RPA or other rental agreements to him. Id. The court recognized that in terms of common law contract, the broker could not "offer" the RPA because the broker could not legally bind HCP to enter into the RPA with the plaintiff and the prior owners had not transferred a legally enforceable option to join the RPA to the plaintiff. Id. at 1457. But the Ninth Circuit stated that the term "offer" under securities law is broader than common law contract and even if the defendant broker could not legally bind HCP to enter into the rental arrangements with the plaintiff, it was "not inappropriate that [the defendant's] offerings be judged as being what they were represented to be." Id. at 1458. "Taken together these facts are sufficient to raise an issue of material fact for the trier to decide whether the RPA and other agreements were part of one scheme or transaction [the broker] offered [the plaintiff]." Id. at 1458.

As described by one district judge, "[i]mpossibility of performance is not dispositive to the court's determination of whether defendants' conduct constituted an 'offer to sell.' What is dispositive to the court's determination is whether defendants'

conduct conditioned the public mind." SEC v. Thomas D. Kienlen Corp., 755 F. Supp. 936, 940 (D. Or. 1991) (addressing "offer" under Section 5[4] of the Securities Act). In Kienlen Corp., the district court found that a notice mailed to clients and a brochure handed out at a meeting constituted "offers to sell" where the defendants promoted the "[g]reater safety,", "improved performance," and "[l]ower costs," of their offering. Id. at 940-41.

In SEC v. Arvida Corp., 169 F. Supp. 211 (S.D.N.Y. 1958), the court found that there was an "offer to sell" under Section 2(3) of the Securities Act, 15 U.S.C. § 77b(a)(3), where the defendant conducted a press conference where a spokesperson for the issuer answered reporters' questions, including questions regarding the proposed offering price per share. Id. at 215. The court found "the furnishing to the press by representatives of the issuer and the underwriters of written and oral communications concerning the forthcoming public offering of the issuer's securities, thereby causing the public distribution of such information through news media, constituted an 'offer to sell.'" Id.

Defendants, in their briefs and at the hearing, argued that an offer requires a "manifestation of intent to be bound" but only cite to California state contract law in support. Based on caselaw defining an "offer" under the securities laws, Defendants' argument seeks to improperly narrow the definition of "offer". Under securities law and caselaw, the definition of "offer" is broad and there is no requirement that performance must be possible or that the issuer must be able to legally bind a purchaser. See Hocking, 885 F.2d at 1457; Kienlen Corp., 755 F. Supp. at 940-41. Thus, the Court concludes that the contents of Defendants' website, the Whitepaper and social media posts concerning

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[4] Sections 5(a) and 5(c) of the Securities Act prohibit the interstate sale of unregistered securities. 15 U.S.C. §§ 773(a) & (c). "In order to establish a Section 5 violation, [plaintiff] must point to evidence that: (1) no registration statement was in effect as to the securities; (2) [defendant] sold or offered to sell the securities; and (3) the sale or offer was made through interstate commerce." SEC v. Phan, 500 F.3d 895, 908 (9th Cir. 2007) (quoting Berckeley Inv. Group, Ltd. v. Colkitt, 455 F.3d 195, 212 (3d Cir. 2006)).

the ICO of the BLV tokens to the public at large constitute an "offer" of "securities" under the Securities Act.

In responding to the TRO, Defendants only challenged whether the BLV tokens were "securities" and did not dispute the remaining elements of a Section 17(a) violation. (Dkt. No. 41 at 9.) In its opposition to the motion for reconsideration, Defendants now challenge the other elements required to demonstrate a violation under Section 17(a) by contending that Plaintiff failed to demonstrate scienter[5] under Section 17(a); failed to point to a defrauded "purchaser" under Section 17(a)(3) and did not receive value for the sale of the security under Section 17(a)(2). The Court declines to consider new arguments raised in an opposition to a motion for reconsideration and not raised on preliminary injunction. See Dodds v. BAC Home Loans Serv., LP, CV. No. 10-00371 DAE, KSC, 2011 WL 1483971, at *9 (D. Haw. Apr. 19, 2011) ("Plaintiff may not raise new arguments in his Opposition for the first time.") Consequently, on reconsideration, the Court concludes that Plaintiff has presented a prima facie showing of previous violations of Section 17(a).

D. Reasonable Likelihood that the Wrong will be Repeated

Second, the SEC argues that the Court erred by relying on promises made by Defendant Ringgold that he would stop the initial coin offering and provide the SEC 30 days' notice before resuming the offering because an unenforceable promise is not a sufficient ground for denying the injunction in light of the fact Ringgold repeatedly made false statements in multiple venues. Defendants argue that Plaintiff has not presented any evidence that the wrong will likely be repeated and, in fact, no wrongdoing has occurred since the preliminary injunction order.

[5] Scienter is a required element of a Section 17(a)(1) violation but not an element of a violation of Sections 17(a)(2) or (3). Aaron v. SEC, 446 U.S. 680, 697 (1980).

On the second factor for injunctive relief, in determining a reasonable likelihood of future violations, the Court must look at the totality of the circumstances concerning Defendants and their violations. See SEC v. Murphy, 626 F.2d 633, 655 (9th Cir. 1980). "[T]he fact that illegal conduct has ceased does not foreclose injunctive relief." SEC v. Koracorp Industries, Inc., 575 F.2d 692, 698 (9th Cir. 1978). "Promises of reformation and acts of contrition are relevant in deciding whether an injunction shall issue, but neither is conclusive or even necessarily persuasive, especially if no evidence of remorse surfaces until the violator is caught." Id. In considering the totality of the circumstances, courts should consider factors such as "degree of scienter involved; the isolated or recurrent nature of the infraction; the defendant's recognition of the wrongful nature of his conduct; the likelihood, because of defendant's professional occupation, that future violations might occur; and the sincerity of his assurances against future violations." Murphy, 626 F.2d at 655. Past violations "may give rise to an inference that there will be future violations." Id.; SEC v. Mgmt. Dynamics, Inc., 515 F.2d 801, 807 (2d Cir. 1975) ("[t]he commission of past illegal conduct is highly suggestive of the likelihood of future violations.").

In Koracorp, the Ninth Circuit reversed the summary judgment ruling in favor of the defendants on the issue of whether there will be future violations. The court noted that on the issue of the "extent of the culpability of the several defendants" in relation to likelihood of recurrent securities laws violations, the court is required "to prove the defendants' states of mind" which requires an inquiry into the "the character of past violations" and the "bona fides of the expressed intent to comply." 575 F.2d at 698-99 ("Neither the character of a defendant's past violations nor the bona fides of an expressed intent to comply can be ascertained without determination of the acts and conduct of each of these defendants in connection with the securities violations."). Similarly, in Murphy, the Ninth Circuit affirmed the district court grant of permanent injunction on a summary judgment motion noting that the evidence supported an injunction where the evidence shows that defendant had "acted recklessly" and had repeated violations but insisted he

had done nothing wrong. Murphy, 626 F.2d at 655. Moreover, the defendant's new venture provided him with ample opportunity for continued violations. Id.

In its prior order, the Court considered the totality of the circumstances, without the benefit of full discovery, and concluded that the wrong would not be likely repeated because Ringgold recognized that mistakes were made and he intended to comply with the securities law and stated in a declaration that he had ceased all efforts to proceed with the ICO. Moreover, the Court noted that after Defendants had retained counsel, they stopped making false statements about the ICO of the BLV tokens. The Court also concluded that the SEC had not demonstrated a prima facie case of past violations of securities laws.

In the instant motion, the Court grants a partial reconsideration and concludes that Plaintiff has presented a prima facie case of violations of Section 17(a), which creates an inference that Defendants will likely violate the securities law in the future if not enjoined. See Mgmt. Dynamics, Inc., 515 F.2d at 807. The misrepresentations on Defendants' website postings include falsely claiming their ICO has been "registered" and "approved" by the SEC, falsely claiming their ICO has been approved or endorsed by the CFTC and the NFA by utilizing their logos and seals, falsely asserting they are "partnered" with and "audited by" Deloitte, and falsely creating a fictitious regulatory agency, the BEC, with a fake government seal, logo, and mission statement that are nearly identical to the SEC's seal, logo and mission statement. Ringgold does not dispute that these false representations were on the website; instead, he claims that mistakes were made. (Dkt. No. 24, Ringgold Decl. ¶ 14.) The Court recognizes that Defendants could have reasonably made a mistake as to their SEC filings as they had hired a compliance attorney; however, the Court questions Defendants' mistake concerning the creation of fictitious agency, BEC, utilizing a nearly identical seal, logo and mission statement as the SEC to provide a false appearance that the ICO had regulatory approval and was safe.

Moreover, in the motion to withdraw as counsel, defense counsel explained that the firm found it necessary to terminate representation due to, *inter alia*, Defendants

instructing defense counsel to file certain documents that counsel could not certify under Federal Rule of Civil Procedure 11.[6] (Dkt. No. 47-1, Morris Decl. ¶¶ 8, 9.) In fact, when defense counsel declined to file the documents, Defendants attempted to file such documents with the Court without counsel's permission or signature and the documents were rejected by the Court Clerk. (Id. ¶ 9.) While Defendants have been notified of defense counsel's intention to withdraw as well as the pending motion to withdraw as counsel, they have yet to find substitute counsel. In light of the Court's order granting defense counsel's motion to withdraw as counsel, the Court has concerns whether Defendants will resume their prior alleged fraudulent conduct.

Thus, in consideration the totality of the circumstances concerning Defendants and their alleged Section 17(a) violations, and because Ringgold sought to file documents that were not in compliance with Rule 11, the Court reconsiders its ruling and concludes that there is a reasonable likelihood of future violations of Section 17(a) based on newly developed facts under Rule 59. Moreover, because Ringgold, in his opposition, agreed to stop pursuing the ICO and to stop violating securities laws, (Dkt. No. 24, Ringgold Decl. ¶¶ 16, 17), a narrow injunction limited to Section 17(a) violations until a trial is held will not be burdensome on Defendants.

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[6] Rule 11 provides,

> By presenting to the court a pleading, written motion, or other paper--whether by signing, filing, submitting, or later advocating it--an attorney or unrepresented party certifies that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances:
> (1) it is not being presented for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation;
> (2) the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law;
> (3) the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery; and
> (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on belief or a lack of information.

Fed. R. Civ. P. 11

Conclusion

Based on the above, the Court GRANTS Plaintiff's motion for partial reconsideration on Section 17(a) of the Securities Act of 1933 and GRANTS Plaintiff's motion for preliminary injunction. Accordingly, IT IS HEREBY FURTHER ORDERED that Defendants Blockvest and Ringgold are preliminarily enjoined from violating Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)] in the offer or sale of any security by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly:

> (a) to employ any device, scheme, or artifice to defraud;
> (b) to obtain money or property by means of any untrue statement of a material fact or any omission of a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
> (c) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

IT IS SO ORDERED.

Dated: February 14, 2019

Hon. Gonzalo P. Curiel
United States District Judge

TAB 13

Pierce, Release No. 11157 (Securities and Exchange Commission, Feb. 27, 2023)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 11157 / February 17, 2023

ADMINISTRATIVE PROCEEDING
File No. 3 - 21305

In the Matter of **PAUL ANTHONY PIERCE,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") against Paul Anthony Pierce ("Pierce" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. Between May 26, 2021, and June 5, 2021, Pierce—a former professional basketball player and sports analyst—touted on Twitter a crypto asset security that was being offered and

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

sold. Pierce, at least negligently, made materially false and misleading misstatements in his Twitter posts promoting the crypto asset security, including statements regarding the amount he had earned from holding the crypto asset security, and statements indicating that he was holding—and intended to increase—his investment in the crypto asset security while contemporaneously selling the securities. Pierce's conduct violated Section 17(a)(2) of the Securities Act, which prohibits obtaining money or property by means of an untrue statement of a material fact or any omission of material facts necessary to make statements made not misleading in the offer or sale of securities.

2. In addition, Pierce did not disclose that he was being compensated by the entity offering and selling the security for giving the crypto asset security publicity. Pierce's failure to disclose this compensation violated Section 17(b) of the Securities Act, which makes it unlawful for any person to promote a security without fully disclosing the receipt and amount of such consideration from an issuer.

Respondent

3. **Pierce**, age 45, is a resident of Los Angeles, California.

Facts

4. Pierce promoted a crypto asset security on his Twitter account in exchange for financial payment from the issuer. He received crypto asset securities worth approximately $244,116 for his promotions. At the time of his promotions, Pierce had in excess of approximately 4 million Twitter followers.

5. Specifically, Pierce promoted a securities offering conducted by EthereumMax, an online company with a public website ("EthereumMax" or the "Company"), in which it offered and sold digital "Emax tokens" ("EMAX") to the general public. The EMAX tokens promoted by Pierce were offered and sold as investment contracts and therefore were securities pursuant to Section 2(a)(1) of the Securities Act.

6. Starting on approximately May 14, 2021, EthereumMax made the EMAX tokens available for public trading on a so-called "decentralized" crypto asset trading platform.

7. Based on EthereumMax's marketing materials, as well as public statements by EthereumMax affiliates, the EthereumMax website, and EthereumMax social media handles, purchasers of EMAX tokens would have had a reasonable expectation of profits from their investment in the tokens. EthereumMax frequently touted the token's rise in price on its social media pages as it offered and sold EMAX tokens.

8. Based on EthereumMax's public statements, purchasers of the EMAX tokens would have had a reasonable expectation that EthereumMax and its agents would expend significant efforts to develop the EthereumMax platform, which would increase the value of their EMAX tokens, resulting in investor profit. EthereumMax's marketing materials highlighted that the Company and its agents would ensure a secondary trading market for EMAX tokens by creating a trading market for EMAX tokens. EthereumMax's marketing materials also emphasized the purported expertise of the Company's management.

9. EthereumMax's marketing materials, moreover, contained numerous direct statements that the EMAX tokens would rise in value as a result of the efforts of the Company and its agents, including by touting future deals and relationships that would "drive value." EthereumMax also promised to develop certain "token enhancements," including "additional tokenomics to enhance economic value," future rewards and staking programs, national sporting and event partnerships, and a general expansion of the EMAX token ecosystem.

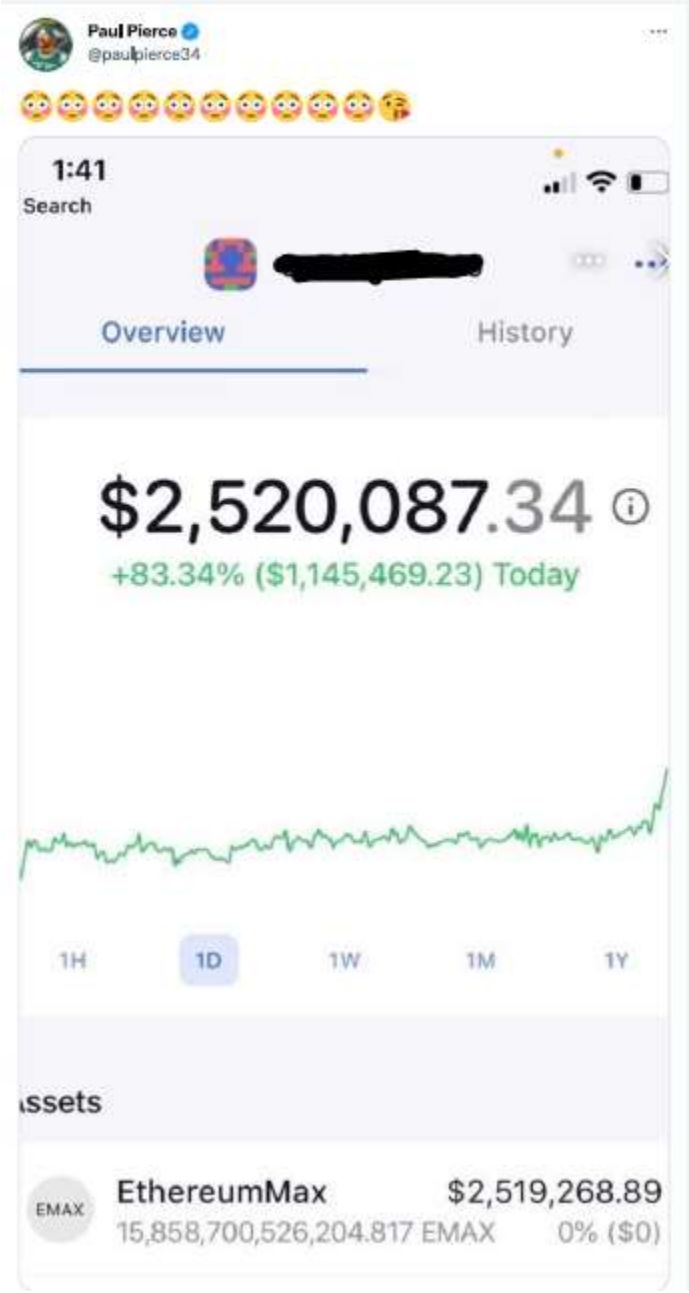
10. On May 24, 2021, EthereumMax and/or its agents began transferring EMAX tokens to Pierce in exchange for his agreement to make social media posts promoting the tokens. Pierce received at least 8 transfers of EMAX tokens through June 18, 2021. Pierce accepted the tokens as compensation for his promotional services in lieu of payments in dollars.

11. On May 26, 2021, Pierce—who had been let go by ESPN in April 2021—promoted EthereumMax's offering on social media by posting the following to his Twitter account:

The post contained a link to the EthereumMax website, where instructions were provided for potential investors to purchase EMAX tokens. Pierce did not disclose that he was compensated by the issuer for the promotion, nor did he disclose the amount and nature of the compensation.

12. Despite the claim in this Tweet that he "made more money with this crypto in the past month then [*sic*] [he] did with [ESPN] in a year[,]" Pierce was at least negligent in not knowing that this statement was materially misleading. Pierce, whose gross compensation from ESPN was over $1 million the prior year, only received EMAX tokens two days prior to the post, the value of which was approximately $46,000 at the time he was paid.

13. On May 28, 2021, Pierce made the following post on Twitter promoting the EMAX offering without disclosing that the issuer was compensating him for the promotion or the amount of the compensation and without revealing that his own personal holdings were in fact far lower than the $2,520,087 in the screenshot in the Tweet:



14. Pierce was at least negligent in not knowing that this Tweet was materially misleading because it omitted the fact that the screenshot did not reflect his own holdings of EMAX, but instead was a screenshot of another person's holdings provided to him for promotional purposes.

15. On May 29, 2021, Pierce Tweeted "The Goal is 1$ @ethereum_max only then will be out[.]"

16. On May 30, 2021, Pierce posted the following to Twitter: "People asking if they should jump on the @ethereum_max train I'm n [*sic*] for the long haul if u missed out on the 1st wave now is the time to jump on board . . . ."

17. Pierce was at least negligent in not knowing that the statements in Paragraphs 15 and 16 above were materially false and misleading because he was in fact selling EMAX tokens while promoting them. In fact, Pierce had sold large portions of the EMAX tokens that he received as compensation for his posts as early as May 26, 2021, and continued selling EMAX—including on May 29 and May 30, 2021—after making these posts.

18. Moreover, Pierce did not disclose that he was paid by the issuer for the posts in Paragraphs 15 and 16 above nor did he disclose the amount of compensation he received.

19. On May 30, 2021, Pierce also made the following Twitter post promoting the EMAX offering without disclosing that he was compensated by the issuer for the Tweet or the amount of the compensation:

The rocket ship image—along with other space images, analogies, and phrases such as "to the moon"—are widely-used in the crypto asset space to signal expectations that a token will dramatically increase in value.

20. On June 5, 2021, Pierce Tweeted: "Gonna double down know [*sic*] @ethereum_max[,]" indicating that he was going to increase his investment in the crypto asset security. In fact, Pierce continued selling his tokens over the next week, including at least one sale on the date of the post. Pierce was at least negligent in not knowing that this post was false and misleading.

21. In addition, Pierce did not disclose that he was paid by the issuer for the posts in Paragraphs 19 and 20 above or the amount of compensation he received.

22. In total, Pierce received approximately 1,622,319,996,192 EMAX tokens, worth approximately $244,116 at the time he received them, from EthereumMax and/or its agents between May 24, 2021 and June 18, 2021 in exchange for his promotional tweets.

23. Pierce's crypto asset security promotion occurred after the Commission warned in its July 25, 2017, DAO Report of Investigation that crypto tokens or coins offered and sold may be securities, and those who offer and sell securities in the United States must comply with the federal

securities laws.[2] The promotion also occurred nearly four years after the Commission's Division of Enforcement and Office of Compliance Inspections and Examinations issued a statement reminding market participants that "[a]ny celebrity or other individual who promotes a virtual token or coin that is a security must disclose the nature, scope, and amount of compensation received in exchange for the promotion. A failure to disclose this information is a violation of the anti-touting provisions of the federal securities laws."[3]

Pierce Violated Section 17(a)(2) of the Securities Act

24. As a result of the conduct described above, Pierce at least negligently violated Section 17(a)(2) of the Securities Act, which prohibits obtaining money or property by means of a untrue statement of a material fact or any omission of material facts necessary to make statements made not misleading in the offer or sale of securities.

Pierce Violated Section 17(b) of the Securities Act

25. Section 17(b) of the Securities Act makes it unlawful for any person to:

> publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

Pierce violated Section 17(b) of the Securities Act by touting the EMAX token on his social media account without disclosing that he received compensation from the issuer for doing so, and the amount of the consideration.

Disgorgement and Civil Penalties

26. The disgorgement and prejudgment interest referenced in paragraph IV(C) is consistent with equitable principles and does not exceed Respondent's net profits from his violations and will be distributed to harmed investors, if feasible. The Commission will hold funds paid pursuant to paragraph IV(C) in an account at the United States Treasury pending a decision whether the Commission in its discretion will seek to distribute funds. If a distribution is determined feasible and the Commission makes a distribution, upon approval of the distribution final accounting by the Commission, any amounts remaining that are infeasible to return to investors, and any amounts returned to the Commission in the future that are infeasible to return to investors, may be transferred to the general fund of the U.S. Treasury, subject to Section 21F(g)(3) of the Securities Exchange Act of 1934.

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[2] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Rel. No. 81207 (July 25, 2017).

[3] *See* SEC Staff Statement Urging Caution Around Celebrity Backed ICOs (Nov. 1, 2017), *available at* https://www.sec.gov/news/public-statement/statement-potentially-unlawful-promotion-icos.

Undertakings

27. Respondent has undertaken, for a period of three (3) years from the date of this Order, to forgo receiving or agreeing to receive any form of compensation or consideration, directly or indirectly, from any issuer, underwriter, or dealer, for directly or indirectly publishing, giving publicity to, or circulating any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a crypto asset security for sale, describes such crypto asset security.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act, cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(b) of the Securities Act.

B. Respondent shall comply with the undertaking enumerated in Section III, paragraph 27 above.

C. Respondent shall pay disgorgement of $244,116, prejudgment interest of $15,449, and a civil money penalty in the amount of $1,150,000 to the Securities and Exchange Commission. The Commission may distribute the funds paid pursuant to this paragraph if, in its discretion, the Commission orders the establishment of a Fair Fund pursuant to 15 U.S.C. § 7246, Section 308(a) of the Sarbanes-Oxley Act of 2002. The Commission will hold funds paid pursuant to this paragraph in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or, transfer them to the general fund of the United States Treasury, subject to Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be made in the following installments:

1. Within twenty (20) days of the entry of this Order, Respondent will pay $500,000.

2. Within one hundred and eighty (180) days of the entry of this Order, Respondent will pay $300,000.

3. Within three hundred and sixty (360) days of the entry of this order, Respondent will pay $609,565.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of the civil penalty, plus any additional interest accrued pursuant to 31 U.S.C. 3717 shall be due and payable immediately, without further application.

D. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Paul Anthony Pierce as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to David Hirsch, U.S. Securities and Exchange Commission, Division of Enforcement, 100 F Street, NE, Washington, DC, 20549.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. § 523(a)(19).

By the Commission.

Vanessa A. Countryman
Secretary

TAB 14

"Cryptocurrency 2023 Legislation Summary" National Conference of State Legislatures, https://www.ncsl.org/financial-services/cryptocurrency-2023-legislation. Last updated: March 26, 2023.

https://www.ncsl.org/financial-services/cryptocurrency-2023-legislation

Last visited: 5/10/23

Cryptocurrency 2023 Legislation

State	Bill Number	Bill Title	Bill Status	Bill Summary
Alabama	None			
Alaska	H 86	Money Transmission	Pending	Relates to the business of money transmission, relates to money transmission licenses, licensure requirements, and registration through the Nationwide Multistate Licensing System and Registry, relates to the use of virtual currency for money transmission, relates to authorized delegates of a licensee, relates to acquisition of control of a license, relates to record retention and reporting requirements.
Alaska	S 84	Money Transmission	Pending	Relates to the business of money transmission, relates to money transmission licenses, licensure requirements, and registration through the Nationwide Multistate Licensing System and Registry, relates to the use of virtual currency for money transmission, relates to authorized delegates of a licensee, relates to acquisition of control of a license, relates to record retention and reporting requirements.
Arizona	S 1191	Disbursements and Applicability	Pending	Relates to disbursements, relates to applicability, relates to definition.
Arizona	S 1235	Legal Tender and Specie and Bitcoin	Pending	Relates to legal tender, relates to specie, relates to bitcoin.

Arizona	S 1239	State Agencies and Payments and Cryptocurrency	Pending	Relates to state agencies, relates to payments, relates to cryptocurrency.
Arizona	S 1240	Virtual Currency and Property Tax Exemption	Pending	Relates to virtual currency, relates to property tax exemption.
Arizona	SCR 1007	Property Tax Exemption and Virtual Currency	Pending	Relates to property tax exemption, relates to virtual currency.
Arkansas	H 1438	Uniform Money Services Act	Pending	Amends the Uniform Money Services Act.
Arkansas	H 1588	Uniform Commercial Code	Pending	Amends the uniform commercial code.
California	A 39	Digital Financial Asset Market: Regulatory Oversight	Pending	Enacts the Digital Financial Assets Law. Prohibits a person from engaging in digital financial asset business activity or holding itself out as being able to engage in digital financial asset business activity, with or on behalf of a resident unless any of certain criteria are met, including the person being licensed with the Department of Financial Protection and Innovation.
California	A 76	Money Laundering: Blockchain Technology	Pending	Expands money laundering to include conducting a transaction involving a monetary instrument of specified value using blockchain technology. Expands the definition of a monetary instrument to include virtual assets that use blockchain technology, including, but not limited to, nonfungible tokens and cryptocurrencies.
California	A 1229	Unincorporated Associations: Decentralized Nonprofit	Pending	Adds provisions governing decentralized nonprofit associations, defined as an unincorporated association consisting of at least a specified number of members with a primary common purpose other than to operate a business for profit whose governance and operations are reliant, in full or in part, on a blockchain or other distributed ledger technology.

California	A 1336	Nonfungible Token Marketplaces	Pending	Requires a nonfungible token marketplace, as defined, to disclose the terms and conditions at the time a user contracts with the nonfungible token marketplace.
California	S 95	Commercial Transactions	Pending	Revises provisions of the Commercial Code generally in accordance with the revisions to Articles 1, 2, 2A, 3, 4A, 5, 7, 8, and 9 of, the addition of Article 12 to, and the addition of specified general provisions and definitions, transitional provisions, and effective date provisions to, the Uniform Commercial Code, as proposed in the 2022 Amendments to the Uniform Commercial Code by the National Conference of Commissioners on Uniform State Laws.
California	S 401	Digital Financial Asset Transaction Kiosks	Pending	Provides for the regulation of digital financial asset transaction kiosks, as defined, by the Department of Financial Protection and Innovation. Prohibits, among other things, an operator, as defined, from accepting or dispensing more than $1,000 in a day from or to a resident via a digital financial asset transaction kiosk.
Colorado	H 1086	Due Process Asset Forfeiture Act	Pending	Concerns enactment of the Due Process Asset Forfeiture Act.
Colorado	S 90	Uniform Commercial Code Amendments	Pending	Makes changes to the Uniform Commercial Code drafted by the Uniform Law Commission, amends definitions, updates the provisions of the UCC related to secured transactions by, among other things, addressing security interests and rights to payment related to controllable electronic records and specifying how to perfect security interests in controllable accounts and controllable payment intangibles.
Connecticut	H 6752	Digital Assets	Pending	Concerns digital assets, authorizes the banking commissioner to adopt, amend and rescind regulations, forms and orders governing the business use of digital assets, defines virtual currency address, virtual currency kiosk and virtual currency wallet, establishes certain requirements applicable

				to owners or operators of virtual currency kiosks.
Connecticut	S 262	Purchase of Cryptocurrency with a Credit or Debit Card	Pending	Concerns the purchase of cryptocurrency with a credit or debit card, provides that cryptocurrency may be purchased with a credit card or debit card.
Delaware	None			
District of Columbia	B25-5	Uniform Commercial Code Amendment Act of 2023	Pending	Amends the Uniform Commercial Code, Subtitle I of Title 28 of the District of Columbia Code, to add a new Article 12 Controllable Electronic Records, to provide rules for transactions involving digital assets, including cryptocurrency, non-fungible tokens, and electronic promises to pay, and to provide for their negotiability and their perfection by control.
Florida	None			
Georgia	H 55	Banking and Finance	To governor	Merges money transmitter and seller of payment instrument licensing and regulation requirements, provides for restrictions on banking and trust nomenclature, provides for trust powers, provides for credit union powers, provides for membership of credit union audit and credit committees, provides for credit union loans and dividends, provides exemptions from money transmission licensing requirements, provides that a foreign bank may not engage in business in the State unless under specified conditions.
Georgia	H 219	Banking and finance	Pending	Relates to records and reports of currency transactions, so as to provide for venue for the offense of money laundering, provides for legislative findings, relates to theft, so as to provide for venue for the offense of theft of money held in a financial institution, provides for legislative findings, provides for related matters, repeals conflicting laws.
Guam	None			

Hawaii	H 525	Controllable Electronic Records	Pending	Provides that if chattel paper is evidenced only by an authoritative electronic copy of the chattel paper or is evidenced by an authoritative electronic copy and an authoritative tangible copy, the local law of the chattel paper's jurisdiction shall govern perfection, the effect of perfection or nonperfection, and the priority of a security interest in the chattel paper, regardless of whether the transaction bears any relation to the chattel paper's jurisdiction.
Hawaii	H 790	Digital Currency Companies	Pending	Establishes a licensing program that will replace the digital currency innovation lab, appropriates funds to the Department of Commerce and Consumer Affairs.
Hawaii	H 1261	Digital Currency Companies Regulation	Pending	Provides that criminal history record checks may be conducted by specified entities, including but not limited to the Department of Commerce and Consumer affairs on each control person, executive officer, director, general partner, and managing member of a special purpose digital currency company licensee, or an applicant for a special purpose digital currency license, appropriates funds.
Hawaii	S 352	Uniform Commercial Code	Pending	Implements amendments to the Uniform Commercial Code set forth by the Uniform Law Commission.
Hawaii	S 945	Digital Currency Companies	Pending	Establishes a licensing program that will replace the Digital Currency Innovation Lab, appropriates funds.
Idaho	H 188	Revised Unclaimed Property Act	Pending	Repeals and adds to existing law to enact the Revised Unclaimed Property Act.
Illinois	H 3479	Uniform Money Transmission Modernization Act	Pending	Creates the Uniform Money Transmission Modernization Act, provides that the provisions supersede the Transmitters of Money Act, sets forth provisions concerning money transmission licenses, acquisition of control, reports and records, authorized delegates, timely transmission, refunds, and disclosures, prudential

				standards, enforcement, creates the Digital Assets Regulation Act.
Illinois	S 1239	Cryptocurrency and Cryptocurrency Mining	Pending	Amends the Civil Administrative Code, defines cryptocurrency and cryptocurrency mining, changes the definition of qualifying data center to include data centers engaged in cryptocurrency mining that made or committed to make a capital investment over a 60-month period prior to the effective date of the amendatory act.
Illinois	S 1718	Corporate Fiduciary Act	Pending	Amends the Corporate Fiduciary Act to create the Special Purpose Trust Company Authority and Organization Article, provides that a corporation that has been or shall be incorporated under the general corporation Laws of the State for the special purpose of providing fiduciary custodial services or providing other like or related services as specified by rule may be appointed to act as a fiduciary with respect to such services and shall be designated a special purpose trust company.
Indiana	S 468	Uniform Commercial Code Amendments	Pending	Amends the Uniform Commercial Code in relation to emerging technologies, general provisions and definitions, sales, leases, negotiable instruments, fund transfers, letters of credit, documents of title, investment securities, and secured transactions, establishes a new chapter in the UCC that governs controllable electronic records and incorporates the provisions of the ULC's amendments governing controllable electronic records.
Iowa	H 618	Commercial Transactions	Pending	Relates to commercial transactions, includes control and transmission of electronic records and digital assets.
Iowa	S 540	Commercial Transactions	Pending	Relates to commercial transactions, including control and transmission of electronic records and digital assets.

Kansas	H 2167	Regulate the Use of Cryptocurrency in Campaign Finance	Failed	Relates to amending the Campaign Finance Act to regulate and limit the use of cryptocurrency and to prohibit the use of any political funds collected by a candidate or candidate committee for a candidate for federal office.
Kansas	S 204	Technology Enabled Fiduciary Financial Institutions Act	Pending	Replacing the definition of charitable beneficiaries with qualified charities in the technology-enabled fiduciary financial institutions act.
Kentucky	S 64	Uniform Commercial Code	Pending	Establishes transactions subject to provisions of article, amends various sections of Articles 2, 2A, 4A, and 9 of KRS Chapter 355 to remove writing requirements, establishes when article applies to hybrid leases, amends definition of negotiable instrument in KRS 355.3-104, accommodates electronic transactions, modifies security procedure requirements relating to funds transfers, establishes governing law standards for letters of credit.
Louisiana	None			
Maine	H 59	Digital Assets	Pending	Creates a new Uniform Commercial Code article on controllable electronic records, updates a specified article to allow perfection of security interests in digital assets, promotes new rules for mixed transactions involving both goods and services, updates rules for electronic negotiable instruments.
Maine	S 409	Virtual Currency	Pending	Makes clear that this type of financial institution may hold virtual currency or other digital assets.
Maryland	H 192	Campaign Finance Entity Cryptocurrency Prohibitions	Pending	Prohibits a campaign finance entity from depositing funds in a cryptocurrency account, prohibits certain persons subject to campaign finance regulation from making or accepting contributions or donations using cryptocurrency, prohibits a campaign finance entity or a person acting on behalf of a campaign finance entity from making

				an expenditure using cryptocurrency, authorizes the state administrator of elections or the administrator's designee to investigate certain violations.
Maryland	S 269	Campaign Finance Cryptocurrency Prohibitions	Pending	Prohibits a campaign finance entity from depositing funds in a cryptocurrency account, prohibits certain persons subject to campaign finance regulation from making or accepting contributions or donations using cryptocurrency, prohibits a campaign finance entity or a person acting on behalf of a campaign finance entity from making an expenditure using cryptocurrency, authorizes the state administrator of elections or the administrator's designee to investigate certain violations.
Massachusetts	H 69	Blockchain and Cryptocurrency	Pending	Establishes a special commission on blockchain and cryptocurrency.
Massachusetts	H 70	Cryptocurrencies and Digital Assets	Pending	Provides that the office of the state treasurer will develop and periodically review and update a digital module and resources on cryptocurrencies and digital assets.
Massachusetts	S 29	Blockchain and Cryptocurrency	Pending	Establishes a special commission on blockchain and cryptocurrency.
Massachusetts	S 690	Consumers in Cryptocurrency Exchanges	Pending	Protects consumers in cryptocurrency exchanges.
Michigan	None			
Minnesota	H 1176	Third-Party Payers and Dental Providers	Pending	Relates to insurance, specifies provisions for third-party payers and dental providers.
Minnesota	H 2392	Campaign Finance	Pending	Relates to campaign finance, modifies certain campaign finance provisions, provides civil penalties.
Minnesota	H 2680	Department of Commerce Biennial Budget	Pending	Relates to commerce, establishes a biennial budget for Department of Commerce, modifies various provisions governing insurance, establishes a strengthen

				Minnesota homes program, regulates money transmitters, establishes and modifies provisions governing energy, renewable energy, and utility regulation, establishes a state competitiveness fund, makes technical changes, establishes penalties, authorizes administrative rulemaking, requires reports.
Minnesota	H 2754	Department of Commerce Biennial Budget	Pending	Relates to commerce, establishes a biennial budget for Department of Commerce, modifies various provisions governing insurance, establishes a strengthen Minnesota homes program, regulates money transmitters, establishes and modifies provisions governing energy, renewable energy, and utility regulation, establishes a state competitiveness fund, makes technical changes, establishes penalties, authorizes administrative rulemaking, requires reports, appropriates money.
Minnesota	S 1265	Third-Party Payers and Dental Providers	Pending	Relates to insurance, specifies provisions for third-party payers and dental providers.
Minnesota	S 1362	Elections	Pending	Relates to elections, makes technical and clarifying changes.
Minnesota	S 1943	Campaign Finance	Pending	Relates to campaign finance, modifies certain campaign finance provisions, provides civil penalties.
Minnesota	S 2744	Biennial Budget for Department of Commerce	Pending	Relates to commerce, establishes a biennial budget for Department of Commerce, modifies various provisions governing insurance, establishes a strengthen Minnesota homes program, regulates money transmitters, establishes and modifies provisions governing energy, renewable energy, and utility regulation, establishes a state competitiveness fund, makes technical changes, establishes penalties, authorizes administrative rulemaking, requires reports, appropriates money.

Minnesota	S 2847	Biennial Budget for Department of Commerce	Pending	Relates to commerce, establishes a biennial budget for Department of Commerce, modifies various provisions governing insurance, establishes a strengthen Minnesota homes program, regulates money transmitters, establishes and modifies provisions governing energy, renewable energy, and utility regulation, establishes a state competitiveness fund, makes technical changes, establishes penalties, authorizes administrative rulemaking, requires reports, appropriates money.
Mississippi	H 848	Mississippi Digital Asset Mining Act	Pending	Creates the state digital asset mining act, defines the term virtual currency, provides an exemption for the buying, selling, issuing, receiving or taking custody of virtual currency under the state money transmitters act.
Mississippi	H 849	Open Blockchain Token Exchange	Failed	Provides that a person who develops, sells or facilitates the exchange of an open blockchain token is not subject to certain securities and money transmission Laws, authorizes certain verification authority to the secretary of state, provides an exemption for a person who develops, sells or facilitates the exchange of an open blockchain token, revises the definitions of the terms broker dealer and security to provide that the terms do not include a person who develops, sells or facilitates the exchange.
Mississippi	H 1290	Orphaned Well Cryptocurrency Mining Partnership Program	Failed	Creates the Orphaned Well Cryptocurrency Mining Partnership Program for the purpose of authorizing cryptocurrency miners to assume liability of plugging, remediating, or reclaiming orphaned wells, in return for temporary control of the energy from the well, requires the state department of environmental quality to administer the program, defines certain terms relating to orphaned wells and cryptocurrency mining, creates the

				orphaned well cryptocurrency mining partnership program fund.
Mississippi	S 2435	Orphaned Well Partnership Program	Failed	Creates the orphaned well partnership program.
Mississippi	S 2603	Digital Asset Mining Act	Failed	Creates the Mississippi Digital Asset Mining Act, defines the term virtual currency, provides an exemption for the buying, selling, issuing, receiving or taking custody of virtual currency under the state money transmitters act.
Missouri	H 586	Division of Finance	Pending	Modifies provisions relating to the Division of Finance.
Missouri	H 725	Offenses Involving Teller Machines	Pending	Modifies and establishes offenses involving teller machines.
Missouri	H 764	Digital Asset Mining and Virtual Currencies	Pending	Establishes provisions relating to digital asset mining and virtual currencies.
Missouri	H 1108	Sexual Offender Registry	Pending	Modifies provisions relating to the sexual offender registry.
Missouri	H 1165	Uniform Commercial Code	Pending	Modifies and establishes provisions relating to the Uniform Commercial Code.
Missouri	H 1375	Gold and Silver	Pending	Creates and modifies provisions relating to gold and silver.
Missouri	S 100	Gold and Silver	Pending	Creates and modifies provisions relating to gold and silver.
Missouri	S 186	Criminal Offenses Involving Teller Machines	Pending	Modifies provisions relating to criminal offenses involving teller machines.
Missouri	S 536	Digital Mining	Pending	Relates to digital mining.
Missouri	S 692	Virtual Currency	Pending	Creates new provisions relating to virtual currency.
Montana	H 136	Revised Unclaimed Property Act	Pending	Adopts Revised Unclaimed Property Act, relates to money transfer, relates to property, relates to rule making.

Montana	S 178	Cryptocurrency Laws	Pending	Provides that digital assets used as a method of payment may not be subject to any additional tax, withholding, assessment, or charge by the state or a local government that is based solely on the use of the digital asset as the method of payment.
Montana	S 370	Uniform Commercial Code	Pending	Revises Uniform Commercial Code, relates to credit transactions.
Nebraska	L 94	Uniform Commercial Code	Pending	Adopts and changes provisions for controllable electronic records under the Uniform Commercial Code.
Nebraska	L 214	Changes to Federal Law Regarding Banking and Finance	Pending	Adopts changes to federal law regarding banking and finance and change provisions relating to digital asset depositories, loan brokers, mortgage loan originators, and installment loans.
Nebraska	L 669	Director of Banking and Finance	Pending	Provides powers for the director of banking and finance regarding conditions on financial institutions.
Nebraska	L 674	Digital Asset Depositories	Pending	Changes provisions relating to digital asset depositories.
Nevada	A 55	Uniform Unclaimed Property Act	Pending	Relates to unclaimed property, revises provisions of the Uniform Unclaimed Property Act, closes title an act relating to unclaimed property, revises provisions of the Uniform Unclaimed Property Act.
Nevada	S 165	Emerging Technologies Task Force	Pending	Relates to technology, creates the Emerging Technologies Task Force within the Department of Business and Industry, prescribes the membership, powers and duties of the task Force, authorizes the director of the to create an Opportunity Center for Emerging Technology Businesses as part of the Office of Business Finance and Planning of the Department, provides other matters properly relating thereto.
Nevada	S 333	Virtual Currency Business Activity	Pending	Relates to virtual currency, requires a virtual currency business to provide to the

				commissioner of financial institutions a written disclosure before engaging in virtual currency business activity with or on behalf of a resident of this state, creates the Virtual Currency Recovery Account, requires a virtual currency business to pay to the commissioner an annual assessment, authorizes the commissioner to award grants to certain residents who are customers of certain virtual currency businesses.
Nevada	S 360	Digital Financial Asset Business Activity	Pending	Relates to digital financial assets, provides for the licensure and regulation of persons engaged in digital financial asset business activity, sets forth certain requirements concerning the operations of a person who is licensed to engage in digital financial asset business activity, provides penalties, provides other matters properly relating thereto.
New Hampshire	H 225	Privacy Rights	Pending	Provides that no currency, whether tangible, digital, or otherwise, which inherently compromises privacy by provision of transaction or usage details to any government agency or partner, allows programming of prohibited or mandatory uses, has the ability to block or refuse any lawful transactions, can be connected to any form of credit score, can be programmed with an expiration date, or can be programmed with non-market driven inflation, may be used as legal tender by any entity for any debts in the state.
New Hampshire	H 584	Controllable Electronic Records	Pending	Makes changes to the Uniform Commercial Code relative to controllable electronic records.
New Hampshire	H 645	Decentralized Autonomous Organizations	Pending	Establishes decentralized autonomous organizations within the state.
New Jersey	A 385	Digital Payment Platform	Pending	Requires the Department of Treasury to review and approve a digital payment platform.

New Jersey	A 1975	Virtual Currency and Blockchain Regulation Act	Pending	Relates to virtual currency and blockchain, amends definition of digital asset and digital consumer asset, game-related digital content, stablecoin, and virtual currency, provides that a qualifying financial institution may serve as a qualified custodian under federal Securities and Exchange Commission rules established pursuant to 17 C.F.R. section 275.206(4), provides that in performing custodial services, a qualifying financial institution shall take specified actions.
New Jersey	A 2371	Digital Asset and Blockchain Technology Act	Pending	Relates to the Digital Asset and Blockchain Technology Act and Nationwide Multistate Licensing System, provides that the Bureau of Securities in the Division of Consumer Affairs in the Department of Law and Public Safety shall have the authority to determine whether a person is required to be licensed, provides that the bureau may deny, suspend or revoke a digital asset business license under certain conditions, including but not limited to upon finding that such actions are in the public interest.
New Jersey	A 3287	Virtual Currency and NFTs	Pending	Includes virtual currency and NFTs in definition of gift as applicable to public officials.
New Jersey	A 4355	Financial Literacy Instruction	Pending	Requires public high school students to receive financial literacy instruction on higher education costs, student financial assistance, and cryptocurrencies.
New Jersey	S 1267	Virtual Currency and Blockchain Regulation Act	Pending	Relates to Virtual Currency and Blockchain Regulation Act.
New Jersey	S 1756	Digital Asset and Blockchain Technology Act	Pending	Concerns digital assets and blockchain technology, provides that a person shall not engage in a digital asset business activity, or hold itself out as being able to engage in a digital asset business activity, with or on behalf of a resident, unless the person is licensed in the state by the Bureau of Securities in the Division of Consumer

				Affairs in the Department of Law and Public Safety.
New Jersey	S 3321	Digital Payment Platform	Pending	Requires Department of Treasury to review and approve digital payment platform.
New Mexico	H 90	Controllable Electronic Records	To governor	Relates to commercial transactions, amends, repealing and enacting sections of the uniform commercial code, provides for controllable electronic records.
New Mexico	H 165	Uniformed Unclaimed Property act	To governor	Relates to Uniform Unclaimed Property Act.
New Mexico	H 356	Technology Sandbox Act	Failed - Adjourned	Relates to Technology Sandbox Act.
New York	A 938	Disclosures in Advertisements Involving Virtual Tokens	Pending	Requires certain disclosures by a developer of virtual tokens in advertisements involving such virtual tokens, provides restrictions concerning advertising.
New York	A 944	Offenses of Virtual Token Fraud	Pending	Establishes the offenses of virtual token fraud, illegal rug pulls, private key fraud and fraudulent failure to disclose interest in virtual tokens.
New York	A 954	Cryptocurrency and Blockchain Task Force	Pending	Establishes the New York state cryptocurrency and blockchain study task force to provide the governor and the legislature with information on the effects of the widespread use of cryptocurrencies and other forms of digital currencies and their ancillary systems, including but not limited to blockchain technology, in the state.
New York	A 2318	Disclosures in Advertisements Involving Virtual Tokens	Pending	Requires certain disclosures in advertisements involving virtual tokens.
New York	A 2532	State Agencies and Cryptocurrencies	Pending	Establishes that state agencies are allowed to accept cryptocurrencies such as bitcoin, ethereum, litecoin and bitcoin cash as payment.

New York	A 2599	Task Force to Study State Issued Cryptocurrency	Pending	Establishes a task force to study the impact of a state-issued cryptocurrency on the state of New York.
New York	A 2676	Task Force to Study Economic Empowerment Zones	Pending	Establishes a task force to study the potential designation of economic empowerment zones for the mining of cryptocurrencies in the state of New York.
New York	A 2873	Reporting of Cryptocurrency Holdings	Pending	Relates to reporting of cryptocurrency holdings on the annual statement of financial disclosure.
New York	S 359	Crypto Fraud Offenses	Pending	Establishes certain offenses relating to crypto fraud.
New York	S 360	Disclosures in Advertisements	Pending	Requires certain disclosures in advertisements involving virtual tokens.
New York	S 1891	Cryptocurrency and Blockchain Study Task Force	Pending	Establishes the state cryptocurrency and blockchain study task force to provide the governor and the legislature with information on the effects of the widespread use of cryptocurrencies and other forms of digital currencies and their ancillary systems, including but not limited to blockchain technology in the state.
New York	S 5621	Reporting of Cryptocurrency Holdings	Pending	Relates to reporting of cryptocurrency holdings on the annual statement of financial disclosure filed with the legislative ethics commission or the joint commission on public ethics.
North Carolina	H 237	Criminalizes Money Laundering	Pending	Criminalizes money laundering, establishes an enhanced sentence if a defendant is convicted of an offense and the defendant was wearing a mask, hood, or other clothing or device to conceal or attempt to conceal the defendant's identity.
North Dakota	S 2119	Money Transmitters	**Enacted**	Relates to money transmitters, provides for definitions, provides exemptions from certain requirements, provides that, with specified exceptions, a person may not engage in the business of money transmission without a license, provides that a licensee shall submit a renewal report

				with the renewal fee, in a form and in a medium prescribed by the commissioner of the Department of Financial Institutions, provides that the commissioner may assess a civil penalty for violations.
N. Mariana Islands	Not available			
Ohio	None			
Oklahoma	H 1600	Commercial Digital Asset Mining	Pending	Relates to digital asset mining, provides for a sales tax exemption, specifies exemptions under the State Sales Tax Code, including, between specified dates, the sales of machinery and equipment, including but not limited to, servers and computers, racks, power distribution units, cabling, switchgear, transformers, substations, software, and network equipment, and electricity used for commercial mining of digital assets purposes in a colocation facility.
Oklahoma	H 1633	Legal Tender	Pending	Relates to legal tender, defines terms, requires acceptance of cash as legal tender, provides penalties and enforcement, exempts certain transactions, provides for codification, provides an effective date.
Oklahoma	S 443	Orphaned Well Bitcoin Mining Partnership Program	Pending	Relates to the Corporation Commission, defines terms, creates Orphaned Well Bitcoin Mining Partnership Program, authorizes commission to promulgate rules, requires commission to publish certain program-relevant information, provides for competitive bidding process, provides for confidentiality of certain submitted information, requires participating company submit certain orphaned well site information, provides for good faith negotiation with mineral rights owner.
Oklahoma	S 750	Digital Asset Mining	Pending	Relates to digital asset mining, creates the Commercial Digital Asset Mining Act of 2023, provides short title, states intent, defines terms, provides sales tax exemption for the sale of certain equipment and

				machinery, relates to income tax credit for certain investments, provides credit for investment in certain facilities, updates statutory language, limits credit used to offset tax for certain entities, provides for codification, provides an effective date.
Oregon	H 2816	High Energy Use Facility	Pending	Requires person who owns, operates or controls high energy use facility to ensure that greenhouse gas emissions associated with electricity used by high energy use facility are reduced to 60% below baseline emissions levels by 2027, 80% below baseline emissions levels by 2030, 90% below baseline emissions levels by 2035 and 100% below baseline emissions levels by 2040.
Pennsylvania	H 407	Task Force on Digital Currency	Pending	Establishes a task force on digital currency and the impact on widespread use of cryptocurrency and other forms of digital currencies in this Commonwealth.
Pennsylvania	S 356	Ethics Standards and Financial Disclosure	Pending	Amends Title 65 Public Officers of the Pennsylvania Consolidated Statutes, in ethics standards and financial disclosure, provides for definitions, for restricted activities and for penalties.
Puerto Rico	S 1107	Oversight of the Financing of Political Campaigns	Pending	Relates to the Law for the Oversight of the Financing of Political Campaigns, in order to define what is a digital asset or cryptocurrency, authorizes candidates and committees to accept any digital asset or cryptocurrency as a contribution under Law 222-2011, provides that an increase in the value of the donated digital asset or cryptocurrency held by a candidate or committee must be reported as interest.
Rhode Island	H 5533	Banking Statutes and the Home Loan Protection Act	Pending	Amends outdated provisions of the Banking Statutes and the Home Loan Protection Act, adds consumer protections, including minimum capital requirements and limits on investments, for currency transmitters including crypto currency, adds a consumer protection for student loan borrowers and removes the provision

				allowing deposit of securities in lieu of bond.
Rhode Island	H 5836	Rhode Island Economic Growth Blockchain Act	Pending	Establishes an Economic Growth Blockchain Act, which would regulate virtual and digital assets, establishes depository banks for these purposes.
Rhode Island	S 696	The Banking Statutes and The Home Loan Protection Act	Pending	Amends outdated provisions of the banking statutes and the home loan protection act, adds consumer protections, including minimum capital requirements and limits on investments, adds a consumer protection for student loan borrowers and removes the provision allowing deposit of securities in lieu of bond for currency transmitters including crypto currency.
A. Samoa	Not available			
South Carolina	None			
South Dakota	S 43	Money Transmission Provisions	**Enacted**	Relates to money transmission, provides that a letter of credit must be issued by a federally insured depository financial institution, a foreign bank that is authorized under federal law to maintain a federal agency or federal branch office in a state or states, or a foreign bank that is authorized under state law to maintain a branch in a state that bears an eligible rating or whose parent company bears an eligible rating and is regulated, supervised, and examined by U.S. federal or state authorities.
Tennessee	None			
Texas	H 1666	Commingling of Funds By Digital Asset Service Providers	Pending	Relates to the commingling of funds by digital asset service providers.
Texas	H 1942	Regulation of Sports Wagering	Pending	Relates to the regulation of sports wagering, requires occupational permits, authorizes fees, imposes a tax, decriminalizes wagering on certain sports

				events, creates criminal offenses, provides administrative penalties.
Texas	H 2223	Sales and Use Tax Temporary Exemption	Pending	Relates to the temporary exemption of certain tangible personal property related to virtual currency mines from sales and use taxes.
Texas	H 2690	Liability for Distribution of Abortion Inducing Drugs	Pending	Relates to abortion, including civil liability for distribution of abortion-inducing drugs and duties of Internet service providers, creates a criminal offense, authorizes a private civil right of action.
Texas	H 3573	Modernizing the Regulation of Money Services Businesses	Pending	Relates to modernizing the regulation of money services businesses.
Texas	H 3768	Formation of Decentralized Unincorporated Associations	Pending	Relates to the formation of decentralized unincorporated associations and the use of distributed ledger or blockchain technology for certain business purposes, authorizes a fee.
Texas	H 4278	Orphaned Well Bitcoin Mining Partnership Program	Pending	Relates to the establishment by the Railroad Commission of the state of the orphaned well bitcoin mining partnership program.
Texas	H 4903	Establishment of a Digital Currency Backed by Gold	Pending	Relates to the establishment of a digital currency backed by gold, authorizes a fee.
Texas	H 5011	Amendments to the Uniform Commercial Code	Pending	Relates to amendments to the Uniform Commercial Code, including amendments concerning certain intangible assets and the perfection of security interests in those assets.
Texas	HCR 88	Creation of a Central Bank Digital Currency	Pending	Expresses opposition to the creation of a central bank digital currency.
Texas	HCR 89	Bitcoin Economy in Texas	Pending	Expresses support for the bitcoin economy in the state.

Texas	HJR 146	Constitutional Amendment	Pending	Proposes a constitutional amendment relating to the right to own, hold, and use a mutually agreed upon medium of exchange.
Texas	S 715	Regulation of Sports Wagering	Pending	Relates to the regulation of sports wagering, requires occupational permits, authorizes fees, imposes a tax, decriminalizes wagering on certain sports events, creates criminal offenses, provides administrative penalties.
Texas	S 770	Commingling of Funds By Digital Asset Service Providers	Pending	Relates to the commingling of funds by digital asset service providers.
Texas	S 895	Modernizing the Regulation of Money Services Businesses	Pending	Modernizes the regulation of money services businesses.
Texas	S 1461	Regulation of Online Global Marketplaces	Pending	Relates to regulation of online global marketplaces.
Texas	S 1751	Regulation and Tax Treatment of the ERCOT Power Region	Pending	Relates to the regulation and tax treatment of facilities in the ERCOT power region that demand a large load of interruptible power.
Texas	S 2075	Uniform Commercial Code Amendment	Pending	Relates to amendments to the Uniform Commercial Code, including amendments concerning certain intangible assets and the perfection of security interests in those assets.
Texas	S 2334	Establishment of a Digital Currency Backed by Gold	Pending	Relates to the establishment of a digital currency backed by gold, authorizes a fee.
Texas	SCR 25	Creation of a Central Bank Digital Currency	Pending	Expresses opposition to the creation of a central bank digital currency.
Texas	SJR 67	Mutually Agreed Upon Medium of Exchange	Pending	Proposes a constitutional amendment relating to the right to own, hold, and use a

				mutually agreed upon medium of exchange.
Utah	H 216	Business and Chancery Court Amendments	**Enacted**	Establishes the Business and Chancery Court, addresses the post-judgment interest rate for judgments of the Business and Chancery Court, addresses retention elections for judges of the Business and Chancery Court, addresses salaries for judges of the Business and Chancery Court, provides that the Business and Chancery Court is not geographically divided into districts, provides the number of judges of the Business and Chancery Court, amends the membership of the Judicial Council. Includes disputes regarding cryptocurrency under the jurisdiction of the Business and Chancery Court.
Utah	H 357	Decentralized Autonomous Organizations Amendments	**Enacted**	Allows a decentralized autonomous organization that has not registered as a for profit corporate entity or a nonprofit entity to be treated as the legal equivalent of a domestic limited liability company, enacts the Decentralized Autonomous Organization Act, establishes the requirements of a decentralized autonomous organization to be recognized by the state, establishes the purposes for which a decentralized autonomous organization may be formed, relates to blockchains.
Vermont	None			
Virginia	H 1727	Credit Unions	**Enacted**	Provides that a credit union may provide its customers with virtual currency custody services so long as the credit union has adequate protocols in place to effectively manage risks and comply with applicable laws and, prior to offering virtual currency custody services, the credit union has carefully examined the risks in offering such services through a methodical self-assessment process.
Virginia	H 1784	Securities	Failed	Relates to securities, relates to digital token exemption, relates to decentralized

				autonomous organizations, provides an exemption from securities registration requirements for issuers or sellers of digital tokens, as defined in the bill, under certain circumstances, directs the State Corporation Commission to develop a form and submission process for an issuer or seller of digital tokens to file a notice of intent with the Commission.
U.S. Virgin Islands	None			
Washington	S 5077	Uniform Commercial Code	Pending	Concerns the Uniform Commercial Code.
West Virginia	None			
Wisconsin	None			
Wyoming	H 86	Disclosure of Private Cryptographic Keys	**Enacted**	Prohibits the compelled production of a private key that relates to a digital asset, digital identity or other interest or right, except under specified conditions, defines private key as a unique element of cryptographic data, or any substantially similar analogue, which is held by a person, paired with a unique, publicly available element of cryptographic data, and associated with an algorithm that is necessary to carry out an encryption or decryption required to execute a transaction.
Wyoming	S 75	Decentralized Autonomous Organizations Amendments	**Enacted**	Relates to corporations, amends statutory provisions regulating decentralized autonomous organizations, defines publicly available identifier, provides that articles of organization shall be amended when there is a false or erroneous statement in the articles of organization, the decentralized autonomous organization's smart contracts have been updated or changed, or the publicly available identifier has changed.
Wyoming	S 76	State Digital Asset Registration Act	**Enacted**	Provides for the registration of digital assets with the secretary of state, provides that the Chancery Court shall have

				jurisdiction to hear and decide actions for equitable or declaratory relief and for actions where the prayer for money recovery is an amount exceeding a specified amount, provided the cause of action arises from at least one of the specified circumstances, including a dispute concerning a registered digital asset, provides for appropriations.
Wyoming	S 101	Wyoming Legal Tender Act Amendments	Failed	Relates to the Wyoming Legal Tender Act, requires the state treasurer to provide for the payment of taxes by specie or specie legal tender, requires the state treasurer to determine and provide exchange rates for specie and specie legal tender, requires the state treasurer to exchange specie and specie legal tender for other legal tender currencies, requires the state treasurer to hold and invest specie and specie legal tender.
Wyoming	S 127	Wyoming Stable Token Act	**Enacted**	Relates to trade and commerce, creates the Wyoming Stable Token Act, creates the Wyoming Stable Token Commission, authorizes the commission to issue Wyoming stable tokens, provides for employees, specifies limitations, provides immunity, provides that the commission shall maintain, invest and reinvest the funds received for issuing stable tokens and any earnings from those investments in accordance with investment policies established by rule and regulation of the commission.

TAB 15

White III, Clifford J. "Principles to Guide USTP Enforcement of the Duty of Professionals to Disclose Connections to a Bankruptcy Case Under 11 U.S.C. §§ 327 and 1103 and Fed. R. Bankr. P. 2014." Executive Office for United States Trustees (Dec. 4, 2019)

U.S. Department of Justice

Executive Office for United States Trustees

Office of the Director

Washington, DC 20530

December 4, 2019

MEMORANDUM

TO: United States Trustees

FROM: Clifford J. White III
Director

SUBJECT: Principles to Guide USTP Enforcement of the Duty of Professionals to Disclose Connections to a Bankruptcy Case Under 11 U.S.C. §§ 327 and 1103 and Fed. R. Bankr. P. 2014

Pursuant to 28 U.S.C. § 586(a)(3)(I), the United States Trustee Program (USTP) has an important responsibility to review applications in chapter 11 cases to employ law and other professional firms ("professional firms")[1] that will seek payment from the bankruptcy estate. Due to the multiplicity of interests in a case—from large to small creditors, from employees to other stakeholders—the Bankruptcy Code and Rules mandate that professional firms disclose their connections to other parties in the case and satisfy conflict of interest standards.

Although all parties in a case may object to the adequacy of a professional firm's disclosures and to a professional firm's retention because of potential or actual conflicts, it is usually only the USTP that makes inquiries or files objections. Our role as the "watchdog" of the bankruptcy system is to faithfully read and apply the Code and Rules and to raise issues that we have identified so that the court may make the ultimate determination on a professional firm's employment.

The organizational structure of many professional firms seeking to be retained in bankruptcy cases has grown more complex in recent years. Some professional firms are affiliates of larger businesses that provide a variety of services to clients, both inside and outside of the bankruptcy system. In addition, some professional firms (including parents and affiliates) sponsor funds that invest in their business clients, in distressed debt that may be at issue in a bankruptcy case, or in industries (including competitors of their business clients) to which they provide services.

[1] As used herein, this term includes the individual professionals of a professional firm.

The increasingly complex profile of professional firms subject to the disclosure and conflict provisions of 11 U.S.C §§ 327 and 1103 and Fed. R. Bankr. P. 2014 makes both our review of employment applications and the court's decision on such applications more challenging. Accordingly, set forth below are the general principles that should guide you, as USTP personnel, in reviewing applications to employ professional firms in bankruptcy cases.

1. **Enforce the Law**. The USTP's responsibilities start and stop with a textual reading and expert application of the Bankruptcy Code and Rules. Although professional firms may adopt internal protocols that guide their processes for compliance, these internal protocols cannot change substantive law. Nor can these protocols provide a safe harbor for a firm that does not meet the strict legal requirements governing disclosures and conflicts.

2. **Disclose Connections on the Public Record.** It is the USTP's position that relevant bankruptcy law requires professional firms to disclose on the public record their connections to a case, even if they have a contractual arrangement to keep client information, including client names, confidential. The USTP will argue that a professional firm required to disclose information must either publicly disclose it on the record or file a properly supported motion to seal it under section 107 of the Bankruptcy Code for the court to adjudicate. Should the professional firm choose to file a motion to seal rather than publicly disclose the required information on the record, the USTP has a responsibility to object to any motion that does not satisfy the high bar for sealing.

3. **Disclose Affiliate Connections**. It is the USTP's position that a professional firm being employed must disclose the connections of all its affiliates. Every case is fact specific and, in some circumstances, a professional firm may be able to show that it is sufficiently separate from its affiliates to excuse affiliate disclosure.[2] The applicant seeking to employ the professional firm bears the burden of proof and only the court has authority to excuse affiliate disclosure.

4. **Disclose Connections Based on Investments**. Investments by the professional firm's investment affiliates or by their individual professionals may create conflicts and, depending on the circumstances, those conflicts can be just as serious as conflicts created by working for clients with adverse interests. It is the USTP's position that relevant bankruptcy law requires the professional firm to disclose connections that extend to investments in clients and other entities that may be a party in interest in the case, such as a stalking horse bidder, DIP lender, or other creditor. Investments include direct investments in such entity, as well as investments made through third parties.

In deciding whether investments must be disclosed, the USTP will analyze two key factors: (1) knowledge and (2) control. If the professional firm knew or could have known about the investment in a particular entity that may be involved in the case or an investment in the debtor's industry, then it is the USTP's position that the investment should be disclosed. Or, if the professional firm controlled or could have controlled the selection of the investment in a

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[2] Separate incorporation may not be dispositive of whether affiliate disclosure may be excused. Professional firms routinely disclose connections of their separately incorporated affiliates when, for example, the separate legal entities belong to an international cooperative.

relevant entity or industry, then it is the USTP's position that the investment must be disclosed. Thus, for example, a typical investment in a diversified mutual fund that is managed by an independent outside advisor need not be disclosed. But a professional firm that sponsors pooled investments in clients who may be parties in interest in the case may be required to disclose those investments.

It is vital that the USTP acts consistently from district to district in this and other legal matters. Please ensure that all staff who review chapter 11 retention applications are familiar with these general disclosure principles. Each case will have unique facts that should be considered in a manner consistent with these principles.

The Office of the General Counsel should be consulted if there are any questions regarding these principles or their application in specific cases. This memorandum may be expanded and will be incorporated into the USTP Policy and Practices Manual, which will be made available to the public.[3] This memorandum is an internal directive to guide USTP personnel in carrying out their duties, but the ultimate determination on the obligations of professionals under section 327 and Fed. R. Bankr. P. 2014 resides solely with the court. Nothing in this memorandum has any force or effect of law, and nothing stated herein imposes on parties outside the USTP any obligations that go beyond those set forth in the Bankruptcy Code and Rules.

Thank you for your continued cooperation and diligence in this important area of responsibility.

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[3] The USTP will continue to review and update this internal guidance, as appropriate. Moreover, nothing in this internal guidance: (1) limits the USTP's discretion to request additional information necessary for the review of a particular application; (2) limits the USTP's discretion to file comments or objections to applications, including as to whether a professional firm is disinterested or otherwise satisfies the statutory standards for retention in the case; or (3) creates any private right of action on the part of any person enforceable against the USTP or the United States.

TAB 16

Gargula, M., and May, C. “Investigating the Financial Affairs of a Debtor Who Has Cryptocurrency” *American Bankruptcy Trustee Journal* Spring 2019.

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Investigating the Financial Affairs of a Debtor Who Has Cryptocurrency

By

Nancy J. Gargula
United States Trustee for Regions 10 and 21

Colin May
Bankruptcy Auditor, Office of the U.S. Trustee

- Cryptocurrency assets are appearing in bankruptcy cases with more frequency.
- Trustees should develop procedures for investigating the financial affairs of a debtor with cryptocurrency.
- It is critical that trustees move quickly to safeguard cryptocurrency.
- Trustees should develop procedures for administering cryptocurrency.

Technology advancements abound. Changes are frequent, sometimes daily. And considering the technological climate in which we all live and work, it should come as no surprise that cryptocurrency has impacted a trustee's ability to examine a debtor's financial affairs. The topic of cryptocurrency and bankruptcy has been discussed during NABT trainings and written about in various trustee-related publications (including this Journal). With more and more chapter 7 trustees being assigned to administer cases where the debtors own or have used Bitcoin or other cryptocurrencies, a discussion of the impact on trustee duties and obligations seems the next logical step. These are novel, relatively new[1] financial products that combine speed, technology, and complexity, all of which can be concerning for trustees. This article reviews some basic concepts and characteristics of this revolutionary technology and briefly summarizes some of the strategies that trustees can use to identify, safeguard, and investigate the financial affairs of a debtor who has or had cryptocurrency.

Basics of Cryptocurrency

At its most basic, cryptocurrency (sometimes called virtual or digital currency) is a digital representation of value where technology is used to send or receive funds or transfer a digital asset to someone else. Cryptocurrencies are not in a physical form, only in digital form. Cryptocurrencies are not issued by any central authority, such as a government or a banking system (although cryptocurrency most closely approximates a bank or other financial account in many respects). As a result, cryptocurrencies have no legal tender status in any jurisdiction. Using cryptocurrency as a medium of exchange or a unit of account or to store value requires agreement among a wide community of users of virtual currency.

[1] The first Bitcoin transaction occurred in January 2009.

How are cryptocurrencies acquired and transferred?

Cryptocurrencies, such as Bitcoin, are acquired, stored, transferred and traded on computer networks through a peer-to-peer technology called Blockchain. This is a distributed ledger technology that allows for fast transmission and verification of transactions by a group of computers. The Blockchain keeps a permanent public record of the transactions that is tamper-proof and protects against counterfeiting and double spending. While the transactions are accessible, the true name and identity of the individuals who send or receive funds remain virtually private.

Virtual currency exchanges ("VCEs") are the mediums through which cryptocurrency is acquired, transferred, traded and stored. VCEs act much the same way that foreign exchanges do at airports and other cross-border locations. Payment for the purchase of cryptocurrency is often funded through PayPal transfers, bank ACH transfers, wire transfers or other cryptocurrency payments. In addition to swapping U.S. dollars for Bitcoin (or any other cryptocurrency), VCEs also provide custodial and transfer services for virtual currency and maintain key records that a trustee should obtain in appropriate cases.

How does the owner of cryptocurrency retain the virtual currency?

A digital wallet enables the owner to conduct transactions on the cryptocurrency account, including sending, receiving or otherwise transferring the virtual currency. There are four general types of cryptocurrency "wallets" where evidence of ownership of the cryptocurrency is stored by the owner. A cryptocurrency application or software may reside on a computer or laptop. A mobile device, such as a cell phone, may have the application or software. Web-based wallets may be maintained by a third party, such as a VCE, where the owner accesses the cryptocurrency online. Cryptocurrency can also be retained on a "cold storage wallet"[2] such a USB drive or printed on a piece of paper.

The digital wallet contains two long computer-generated alpha-numeric addresses: a "public key," which is given to others, and a "private key," which is only known to the owner and allows him or her to access the funds. Since there is no central authority involved, a debtor who loses the private key has no ability to recover it[3] (or the value of the currency). The public address is similar to a bank account and routing number, and the private key is similar to the account password or PIN.

To illustrate, a hypothetical Bitcoin owner named Bob has a wallet on Kraken, a VCE. He logs into the VCE's website and, using his private key, authenticates his ownership of the Bitcoin. Since Bob is going through extensive medical treatment, he wants to send his Bitcoin to a relative named Mary for safekeeping. Mary, who doesn't have a Kraken account but does have a

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[2] "Cold storage" refers to the fact that the private key is not connected to the Internet, and thus cannot be easily stolen online.

[3] An owner may, however, retain a "recovery seed," which is a random group of 12 to 16 words that enable him or her to recreate the private key.

virtual currency wallet on her computer (having downloaded the free Bitcoin Core software), is able to give Bob her wallet public key (i.e., the wallet address). This enables Bob to tell Kraken to send the Bitcoin to Mary's virtual currency wallet. Mary uses her own private key to access the funds and authenticate her custody of the transferred funds, once the transaction has been posted to the Blockchain (the public ledger).

How many types of cryptocurrency are there?

As of March 6, 2019, there were over 2,100 active cryptocurrencies listed on coinmarketcap.com. Bitcoin is one of the most commonly seen cryptocurrencies among trustees who have administered cases where the debtor has or had cryptocurrency. Other common cryptocurrencies include Bitcoin Cash, Litecoin, Ethereum and Monero. Each cryptocurrency is unique in how it is stored, traded, purchased and sold. Many of these cryptocurrencies are traded on the largest U.S.-based cryptocurrency exchanges, which are listed below. With over 100 VCEs, only a handful of exchanges have a presence in the United States. Among the ten largest VCEs, only two are U.S.-based.

Identifying and Investigating Cryptocurrency

Often a trustee's biggest challenge is identifying cases where a debtor has or had cryptocurrency in the first place. In many cases, cryptocurrency is not listed in the Schedules or Statement of Financial Affairs. Cases involving cryptocurrency are often identified through reviewing the debtor's bank statements, PayPal transactions and credit card statements.

When reviewing a debtor's financial transactions, trustees should look for payments to or from a VCE using the list provided below as a reference tool. The lengthy computer-generated alpha-numeric address that may appear on these statements is often the sign of a cryptocurrency transaction because the sequence of numbers is too long to be an account number.

Coinbase is one of the largest VCEs and is based in San Francisco. Reviewing bank statements that show a "Coinbase/BTC" or similar entry is often how bankruptcy cases involving cryptocurrency assets or potentially avoidable transfers are found. Other, larger U.S. VCEs are Bittrex, Kraken, and GEMINI. There are also numerous VCEs located in foreign jurisdictions, which pose additional challenges for the trustee. U.S.-based VCEs are regulated by state and federal authorities and must comply by maintaining key financial and customer records. These records are often critical to the investigation of the debtor's financial affairs and should be obtained by the trustee.

Another way to identify a possible cryptocurrency asset is by simply asking the debtor at the section 341 meeting of creditors. A trustee may want to start off with a general question, such as "Within the last 12 months, have you held or used any Bitcoin or other virtual currency?" If the debtor answers yes, then appropriate follow-up questions should come next, such as:

- *When and why did you start using the virtual currency*?

- *What was the purpose of your initial and your subsequent transactions*?

- *In the last 12 months, what was the highest amount of virtual currency that you held*?

- *What exchanges/payment processors do you use?*

- *What e-mail address did you use to create the digital wallets?* (E-mail addresses are how most VCEs track their customer accounts.)

- *Where do you retain your digital wallet?*(See the four types noted above; if on a USB drive or on a piece of paper, ask where the cold storage wallet is located and request immediate turnover.)

- *Where is your private key stored right now*? (Ask the debtor to write it down; if the debtor does not know the private key, ask appropriate follow-up questions.)

- *Did you ever buy virtual currencies for anyone else, sell virtual currencies to anyone else, or conduct any virtual currency transactions on anyone else's behalf?* (This is a possible crime.)

When debtors can't explain financial transactions to the trustee and break them down, they may be trying to hide something. Whether a trustee's case involves undisclosed or undervalued cryptocurrency, or the debtor made false statements about his ownership of and interest in cryptocurrency, it is essential for trustees to report these cases to the Office of the U.S. Trustee, in accordance with the *Handbook for Chapter 7 Panel Trustees* (Section 4.N.7 and 4.N.9).

Safeguarding the Assets

Cryptocurrency transactions are fast and can disappear through a virtually anonymous transaction in an instant. Indeed, the perceived anonymity[4] and speed are major factors that have drawn people to the technology. This ability to conceal the assets or deplete them makes it critical for a trustee to move quickly to safeguard them. Trustees have multiple ways to protect the assets depending on the unique facts and circumstances of each case and the debtor's cooperation. It is essential that the trustee control a debtor's digital wallet and private key to preserve or administer a cryptocurrency asset. Obtaining possession of both is critical.

As with other assets that might not be immediately turned over and that may no longer exist for the trustee to administer when not immediately turned over, a trustee should develop a plan for how cryptocurrency assets will be addressed when they are a part of a debtor's estate. One measure a trustee can take is to reach out to the largest U.S.-based VCEs to determine their procedures for identifying a customer account for cryptocurrency they have exchanged; the information they will need from a trustee to locate a transaction and obtain records; and, perhaps

[4] There are ways to "de-anonymize" and trace transactions through the Blockchain, but they are very technical and involve reviewing layers of transactions and analyzing the patterns.

most importantly, what a trustee would need to do to request that the VCE "freeze" the digital wallet and prohibit any sales, exchanges, transfers or trades of cryptocurrency by the debtor or from the debtor's account.

The chart at the end of this article also contains the website addresses for the listed VCEs for your reference. Remember, records are generally maintained by VCEs based upon the e-mail address or addresses the debtor used when creating his or her account with the exchange. In addition to taking measures to preserve the cryptocurrency asset, it is equally important that a trustee determine what each VCE will need in order for the trustee to obtain turnover of the value of the cryptocurrency in the debtor's account for deposit into the estate's bank account.

Policies and procedures of the VCEs are evolving with the rapid acceptance and use of cryptocurrency. It is very likely that information regarding policies and procedures obtained from an exchange today may be different than the policies and procedures that a trustee may need to follow in the future when cryptocurrency is found to be an asset in a case being administered. The key is to have a plan for how these unique assets will be dealt with and periodically update your plan.

Conclusion

The important work that trustees perform in effectively and efficiently administering their assigned cases while helping the U.S. Trustee Program preserve the integrity of the bankruptcy system can sometimes be challenging, yet very rewarding. We hope this brief discussion of some basic concepts and characteristics of cryptocurrency, along with strategies that trustees can use to identify, safeguard and investigate the financial affairs of a debtor who has or had cryptocurrency, will facilitate overcoming the challenge of this relatively new technological advancement.

LARGEST U.S.-BASED CRYPTOCURRENCY EXCHANGES

BITTREX (Bittrex Inc.) bittrex.com	**BITPAY** (Bitpay Inc.) bitpay.com	**COINBASE** (Coinbase Inc.) www.coinbase.com	**GEMINI** (Gemini Trust Co. LLC) gemini.com
ITBIT (Paxos Trust Co. LLC) www.itbit.com	**KRAKEN** (Payward Ventures Inc.) www.kraken.com	**POLONIEX** (Poloniex LLC) www.poloniex.com	

TAB 17

In re MtGox Co., Ltd. (a/k/a/ MtGox KK), Case No. 14-31229 (Bankr. N.D. Tex.) Doc. No. 2

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Attorneys for the Petitioner Robert Marie Mark Karpeles, Foreign Representative of MtGox Co., Ltd., a/k/a MtGox KK

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

In re	)	Chapter 15
MtGox Co., Ltd. (a/k/a MtGox KK)	)	Case No. 14-_____ (___)
Debtor in a Foreign Proceeding.	)	**Hearing Date: TBD**
	)	**Response Deadline: TBD**

VERIFIED PETITION FOR
RECOGNITION AND CHAPTER 15 RELIEF

Robert Marie Mark Karpeles ("Karpeles"), in his capacity as the foreign representative (the "Petitioner") of MtGox Co., Ltd. a/k/a MtGox KK (the "Debtor" or "MtGox"), a debtor in a civil rehabilitation proceeding under Japanese law (the "Japan Proceeding"), currently pending

before the Twentieth Civil Division of the Tokyo District Court, Japan (the "Tokyo Court"), respectfully submits this verified petition (the "Petition") for recognition as a "foreign representative" of MtGox; for recognition of the Japan Proceeding as a foreign main proceeding; and for emergency, preliminary, and permanent relief under Chapter 15 of title 11 of the United States Bankruptcy Code ("Chapter 15").

PRELIMINARY STATEMENT

1. MtGox is a Japanese corporation formed in 2011. It is, and always has been, located in Tokyo. Since it was formed, and up to mid-February 2014, it was engaged in the business of operating an online bitcoin exchange through the website mtgox.com. At one time, MtGox was reported to be the largest online bitcoin exchange in the world. However, on February 7, 2014, MtGox halted all bitcoin withdrawals by its customers after MtGox became subject to a massive theft or disappearance of bitcoins being held by MtGox both on behalf of its customers and itself. This theft or disappearance is currently the subject of an intense investigation to which MtGox devotes most of its resources. The facts known to date indicate this it was caused or related to a flaw in the software algorithm that underlies bitcoin, and "hacking" attacks of one or more persons. On February 25, 2014, MtGox suspended all trading after internal investigations revealed hundreds of thousands of Bitcoins had been stolen or disappeared.

BACKGROUND

MtGox's Business

2. MtGox is a Japanese corporation, which has always been located in Tokyo, Japan. Until on or around February 25, 2014, it operated an online bitcoin exchange through the website mtgox.com. MtGox has operated this exchange since the summer of 2011. There were times

during this period that MtGox was reported to be the largest online bitcoin exchange in the world, but that is no longer the case.

3. As set forth in the Declaration of Robert Marie Mark Karpeles (the "Karpeles Declaration"), bitcoin is a form of digital currency that was first conceived of in 2008 by a person or group going by the name of Satoshi Nakamoto. The first actual bitcoin was created, or "mined" in 2009. There are several ways in which a person can obtain bitcoin, including the following:

- Bitcoins are "created" through a computer software algorithm which, at any point in time, resides on thousands of computers on the Internet. Persons who accept to certify bitcoin transactions over the bitcoin peer-to-peer network are remunerated by the issuance of a fixed number of bitcoins which evolves over time. The certification is done by the solving of an "algorithm" with the use of ever-more powerful computers. These persons are called "miners" and the process of obtaining bitcoin in this fashion is called "mining."

- A person can also obtain bitcoins that have already been mined by buying them from another. These transactions can consist of "one-to-one" transactions between a buyer and seller. In addition, a person can buy or sell bitcoin through an online exchange, such as the exchange operated by MtGox on the mtgox.com website. In these exchange transactions, the buyer and seller create accounts at the exchange and then fund the account with currency funds, bitcoin or both. The user can then enter a buy or sell order online and the website will match the buy or sell order with one or more sell or buy orders. The buyer receives an increase in bitcoin in his/her account and the seller receives an increase in currency in his/her account. The bitcoin exchange receives a fee or commission for the transaction.

- A person can also obtain and use bitcoin through commercial or merchant transactions; that is, a person can use bitcoin in certain circumstances to pay for goods and services.

4. Users store bitcoins in a digital "wallet" using either the software provided as part of the bitcoin software or a wallet provided by various providers. MtGox provides a wallet

feature. A wallet can be materialized on a piece of paper and bitcoins need not be stored on a computer.

5. The MtGox exchange allowed persons with MtGox accounts to buy and sell bitcoin among themselves. In this regard, a person was to first open an account at MtGox and was assigned an account number. Once a user wanted to start buying or selling bitcoin on the mtgox website, he or she would need to "fund" the account with currency, bitcoin, or both. In addition, the account holder would be subject to "anti-money laundering" ("AML") procedures. Once the account was "funded," the account holder would have a "currency balance" in the account, corresponding to the amount of currency he or she had a right to withdraw; and, a "bitcoin balance" in the account, corresponding to the amount of bitcoin he or she had a right to withdraw.

MtGox's Capital Structure

6. MtGox has approximately ¥6.5 billion ($63.9 million) in liabilities and approximately ¥3.84 billion ($37.7 million) of assets at present. MtGox has no secured debt. Approximately 12% of the equity in MtGox is held by the developer of the initial MtGox software, Jed MacCaleb, with the remaining equity held by Tibanne Co., Ltd., a Japanese corporation located in Japan.

Business Challenges

7. The mtgox.com website has been subject to numerous attempts by persons to breach its security, create denial of service ("DOS") situations, or to otherwise "hack" the system, and this has been the case since MtGox started operating the website in July 2011. In certain circumstances such attempts have led to the company shutting down the site for periods at a time.

8. On February 7, 2014, all bitcoin withdrawals were halted by MtGox due to the theft or disappearance of hundreds of thousands of bitcoins owned by MtGox customers as well as MtGox itself. The cause of the theft or disappearance is the subject of intensive investigation. It is believed to have been caused or related to a defect or "bug" in the bitcoin software algorithm, which was exploited by one or more persons who had "hacked" the bitcoin network. On February 24, 2014, MtGox suspended all trading after internal investigations discovered a loss of 744,408 bitcoins presumably from this method of theft. These events among others caused MtGox to become insolvent and to file the Japan Proceeding.

MtGox's Japan Proceeding and Civil Rehabilitation under the JCRA

9. In order to protect the MtGox business as a going concern and retain its value while MtGox investigates the theft of the bitcoins under its control and addresses any security defects in the bitcoin exchange, MtGox filed a petition (the "Japan Petition") for the commencement of the Japan Proceeding in the Tokyo Court pursuant to Article 21(1) of the Japanese Civil Rehabilitation Act (*Minji Saisei Ho*) (the "JCRA") on February 28, 2014, reporting that the company had lost almost 750,000 of its customers' bitcoins, and around 100,000 of its own bitcoins, totaling around 7% of all bitcoins in the world, and worth around $473 million near the time of the filing. The Japan Petition is attached as Exhibit A to the accompanying Declaration of Robert Marie Mark Karpeles (the "Karpeles Declaration").[1]

10. The JCRA is intended to be used for the rehabilitation and reorganization of corporate debtors. The Japan Proceeding is a civil rehabilitation. The purpose of a civil rehabilitation proceeding is to formulate a rehabilitation plan as consented to by a requisite number of creditors and confirmed by the court, to appropriately coordinate the relationships of

[1] A translation is currently being performed and will be filed, when available.

rights between creditors and the debtor, with the aim of ensuring rehabilitation of the debtor's business or economic life.

11. In addition to the petition for commencement, MtGox also filed applications for a temporary restraining order and for a comprehensive prohibition order, which were issued by the Tokyo Court on February 28, 2014. At the same time, the Tokyo Court issued orders for the appointment of a supervisor and examiner (collectively, the "Tokyo Court Orders"). The Tokyo Court Orders are attached, together with their English translation, as Exhibits B, C, D, and E respectively, to the Karpeles Declaration.

12. The Tokyo Court appointed Mr. Nobuaki Kobayashi, a Japanese attorney, as MtGox's supervisor and examiner. Under the Tokyo Court Orders, the Debtor cannot execute any agreement with any third party without the consent of the supervisor and examiner. The Debtor however remains free to initiate or pursue any legal proceeding provided that the costs of these proceedings be approved by the supervisor and examiner. On March 10, 2014, Mr. Kobayashi, pursuant to the powers conferred upon him by the Tokyo Court Orders, issued a consent allowing the Debtor to hire Baker & McKenzie to file this Chapter 15 case as counsel of Debtor, allowing the payment of Baker & McKenzie's fees and further acknowledging that this consent was granted at the condition that MtGox's Representative Director Mr. Karpeles, file this Chapter 15 case as the foreign representative of MtGox. A true and correct copy of the application for consent and the consent issued by Mr. Kobayashi is attached, together with an English translation, as Exhibit F to the Karpeles Declaration.

13. The schedule of MtGox's reorganization proceedings has not yet been determined. Upon issuance of the commencement order, the Tokyo Court will set a deadline to file proof of claims, submit a rehabilitation plan, and take other acts consistent with a reorganization or

corporate rehabilitation. As additional steps are taken in the Japan Proceeding, this Court will be advised.

14. This Chapter 15 case is being filed in an effort to maximize recoveries to, and provide for an equitable distribution of value among, all creditors. The enjoining of certain ongoing litigation to which MtGox and its affiliates are parties in conjunction with the protections afforded by the Japan Proceeding is essential to this effort. Please refer to the Gamlen Declaration, which is incorporated and made a part of this Petition as if restated herein, regarding the pending litigation against MtGox and its affiliates.

15. There are no other known foreign proceedings that have been filed by, regarding, or against MtGox and which are pending.

JURISDICTION AND VENUE

16. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334 and 157.

17. Venue is proper in this district pursuant to 28 U.S.C. § 1410. The statutory predicates for relief are sections 105, 1504, 1515, 1517, 1519, 1520 and 1521 of the Bankruptcy Code.

RELIEF REQUESTED

18. The Petitioner respectfully requests the entry of an order granting recognition, in substantially the form attached hereto as **Exhibit A**, and protection pursuant to sections 105, 1504, 1515, 1517, and 1520 of the Bankruptcy Code to the effect that: (i) Mr. Karpeles is duly appointed as MtGox's "foreign representative," as that term is defined in section 101(24) of the Bankruptcy Code; (ii) the Japan Proceeding is granted recognition as a "foreign main proceeding," which includes an interim proceeding, under a law relating to insolvency or the

adjustment of debts, pursuant to sections 101(23) and 1517(a) and (b)(1) of the Bankruptcy Code; and (iii) upon recognition, MtGox shall be entitled to the protections of section 1520(a).

RECOGNITION IS APPROPRIATE

19. As set forth more fully in the accompanying Memorandum of Law in support of, *inter alia*, this Petition, the Petitioner has satisfied each of the requirements for recognition contained in Chapter 15 of the Bankruptcy Code. The Petitioner qualifies as a "foreign representative" as defined in section 101(24) of the Bankruptcy Code. The Japan Proceeding is a "foreign main proceeding" as defined in section 1502(4) of the Bankruptcy Code. The Japan Proceeding is pending in Japan, which is the "center of main interests" for MtGox, as such term is used in sections 1502(4), 1516(c) and 1517(b)(1) of the Bankruptcy Code. There are no other known foreign proceedings by, regarding, or against MtGox that are pending in any other country. The Japan Proceeding is a judicial proceeding under which MtGox's assets and affairs are subject to the supervision of the Tokyo Court, thus meeting the definition of a foreign proceeding as defined in section 101(23) of the Bankruptcy Code.

NOTICE

20. Notice to the parties in accordance with Bankruptcy Rules 1011(b), 2002(q)(1) and 9007 will be provided pursuant to the accompanying Application for an Order Granting Provisional Relief, Scheduling Recognition Hearing, and Specifying Form and Manner of Notice.

NO PRIOR REQUEST

21. The Petitioner has not previously sought the relief requested herein from this or any other court.

* * * *

WHEREFORE, the Petitioner respectfully requests that this Court enter an Order

granting the relief requested herein and such other and further relief as is just and proper.

Dated: March 9, 2014
Dallas, Texas

Respectfully submitted,

BAKER & McKENZIE LLP

By: */s/ David W. Parham*
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- and -

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Attorneys for the Petitioner Robert Marie Mark Karpeles, Foreign Representative of MtGox Co., Ltd., a/k/a MtGox KK

VERIFICATION

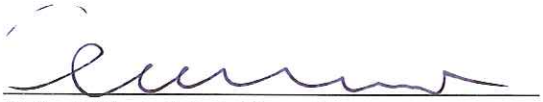
I, Robert Marie Mark Karpeles, hereby declare:

1. I have been authorized by the supervisor and examiner of MtGox to commence this Chapter 15 proceeding.

2. I have read the foregoing Petition and I am informed and I believe that the factual allegations contained therein are true and correct.

3. I verify under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed: Tokyo, Japan
March 10, 2014



Robert Marie Mark Karpeles

TAB 18

In re Three Arrows Cap., Ltd., 647 B.R 440 (Bankr. S.D.N.Y. Dec. 29, 2022)

IN RE: THREE ARROWS CAPITAL, LTD., Debtor in a Foreign Proceeding.

Case No. 22-10920 (MG)

United States Bankruptcy Court, S.D. New York.

Signed December 29, 2022

Background: Duly authorized foreign representatives of Chapter 15 debtor investment firm with focus on trading cryptocurrency and other digital assets moved for entry of order authorizing issuance of subpoenas and granting related relief and for entry of order authorizing alternative service of process.

Holdings: The Bankruptcy Court, Martin Glenn, J., held that:

(1) non-nationals and non-residents outside United States could not be served with subpoenas;

(2) discovery sought from United States national in foreign country was necessary and in interests of justice, as required for service of subpoena;

(3) requiring diligent prior attempt at service on debtor's founder would have been futile; and

(4) alternative service of subpoena via e-mail and social media on debtor's founder who was United States national in foreign country was warranted and reasonably calculated to provide notice.

Motions granted in part and denied in part.

1. Bankruptcy ⚿2341

Non-nationals and non-residents outside United States could not be served with subpoenas by duly authorized foreign representatives of Chapter 15 debtor investment firm with focus on trading cryptocurrency and other digital assets. Fed. R. Civ. P. 45(b)(3).

2. Bankruptcy ⚿2341

Discovery sought from United States national in foreign country was necessary and in interests of justice, as required for service of subpoena in Chapter 15 case to both investigate and marshal assets that had some connection to United States; although there were parallel proceedings, national played paramount and integral role in Chapter 15 debtor's organization, he was only party with knowledge regarding nature, extent, and access to debtor's assets, discovery was conducted with debtor's third-party business counterparts but discovery sought likely was not obtainable via other means, and national had not cooperated with informal discovery requests. 28 U.S.C.A. § 1783(a); Fed. R. Civ. P. 45(b)(3); Fed. R. Bankr. P. 2004.

3. Bankruptcy ⚿3040.1

The Federal Rules of Bankruptcy Procedure provides a freestanding mechanism for discovery regarding the debtor's estate that need not be brought in connection with any pending causes of action. Fed. R. Bankr. P. 2004.

4. Bankruptcy ⚿3044

Bankruptcy court may order production of documents from outside the United States. Fed. R. Civ. P. 45.

5. Bankruptcy ⚿3040.1

One of the key purposes of the Federal Rule of Bankruptcy Procedure which provides a freestanding mechanism for discovery regarding the debtor's estate is to allow those representing or administering a debtor's estate to ascertain the extent of the debtor's liabilities and assets. Fed. R. Bankr. P. 2004.

6. Bankruptcy ⚿3040.1

In assessing whether there are potentially alternative methods to obtain testimony, courts analyze whether it is practical to obtain information sought from witness; sheer impossibility is not required. Fed. R. Civ. P. 45.

7. Bankruptcy ⚿2341

Requiring diligent prior attempt at service on founders of Chapter 15 debtor would have been futile based on submissions by debtor's duly authorized foreign representatives, and therefor absence of evidence showing that futile attempt had been made before foreign representatives filed their service motion was not bar to relief they sought of serving founder via proposed alternative means of e-mail and social media, since founders moved between various countries, concealed their locations, and did not appear to be amenable to service via other avenues, like counsel or registered agent in United States. Fed. R. Civ. P. 45.

8. Witnesses ⚿574

Whether a party seeking leave to serve a subpoena by alternative means has to demonstrate a prior diligent attempt to personally serve the subpoena before permitting alternative service will depend on the circumstances of each case and the reasons why alternative service is sought. Fed. R. Civ. P. 45.

9. Bankruptcy ⚿2341

Alternative service of subpoena outside United States via e-mail and social media by duly authorized foreign representatives of Chapter 15 debtor on debtor's founder who was United States national in foreign country was warranted and reasonably calculated to provide notice, since representatives proposed to serve subpoena via e-mail to e-mail addresses that founder provided to them for purpose of fielding informal discovery questions, founder had recent and actual use of both social media and e-mail accounts, and social media use appeared to be somewhat public and its continued use ostensibly could provide probative evidence of actual receipt of subpoenas. U.S. Const. Amend. 5; 28 U.S.C.A. § 1783; Fed. R. Civ. P. 4(f)(3), 45.

LATHAM & WATKINS LLP, Counsel to the Foreign Representatives of Three Arrows Capital, Ltd., 1271 Avenue of the Americas, New York, NY 10020, By: Adam J. Goldberg, Esq., Brett M. Neve, Esq., Nacif Taousse, Esq., Brian S. Rosen, Esq.

LATHAM & WATKINS LLP, Counsel to the Foreign Representatives of Three Arrows Capital, Ltd., 355 South Grand Avenue, Suite 100, Los Angeles, CA 90071, By: Daniel Scott Schecter, Esq. (admitted pro hac vice), Nima H. Mohebbi, Esq. (admitted pro hac vice), Caitlin Campbell, Esq. (admitted pro hac vice)

HOLLAND & KNIGHT LLP, Counsel to the Foreign Representatives of Three Arrows Capital, Ltd., 31 West 52nd Street, 12th Floor, New York, NY 10019, By: Warren E. Gluck, Esq., Shardul S. Desai, Esq. (pro hac vice pending)

MEMORANDUM OPINION AND ORDER GRANTING IN PART AND DENYING IN PART THE FOREIGN REPRESENTATIVES' SERVICE MOTION

MARTIN GLENN, CHIEF UNITED STATES BANKRUPTCY JUDGE

This Opinion address two motions filed by Russell Crumpler and Christopher Farmer, in their joint capacities as the duly authorized foreign representatives (the "Foreign Representatives") of Three

Arrows Capital, Ltd. (the "Debtor"). Those motions are: (1) the Motion for Entry of an Order Authorizing Issuance of Subpoenas and Granting Related Relief ("Subpoena Motion," ECF Doc. # 54); and (2) Motion for Entry of an Order Authorizing Alternative Service of Process ("Service Motion," ECF Doc. # 55).

Both the Subpoena Motion and Service Motion sought relief related to discovery from Debtor's founders, Su Zhu and Kyle Livingstone Davies (the "Founders") and related entities. (*See* Subpoena Motion ¶ 16.) At the hearing on the Subpoena and Service Motions, the Court informed the Foreign Representatives that there were outstanding legal and factual issues preventing the Court from granting the Service Motion. The Court directed the Foreign Representatives to submit supplemental evidence and legal briefing on those issues before rendering a decision on the Service Motion. The Court granted the Subpoena Motion in the interim, in the event that it became possible to serve the proposed subpoenas without the relief sought (or implicating the concomitant issues identified) in the Service Motion. (*See* "Order Granting the Subpoena Motion," ECF Doc. # 71.)

After receiving the Foreign Representatives' supplemental legal briefing ("Supplemental Brief," ECF Doc. # 75) and evidentiary submissions ("Supplemental Crumpler Decl.," ECF Doc. # 74), the Court issues this Opinion and Order on the Service Motion. For the reasons discussed below, the Service Motion is **GRANTED** with respect to Kyle Davies, and **DENIED** with respect to all other parties.

I. BACKGROUND

A. The Debtor's Business

The Debtor is an investment firm incorporated under the laws of the British Virgin Islands ("BVI") with a focus on trading cryptocurrency and other digital assets. The Debtor was reported to have over $3 billion of assets under management as of April 2022. (Service Motion ¶ 6 (citing "Crumpler Decl.," ECF Doc. # 3 ¶¶ 8–9; "Carroll Decl.," ECF Doc. # 4 ¶ 11).) The Debtor was co-founded by the two Founders, Kyle Livingstone Davies and Su Zhu. (*Id.* ¶ 8.) Both Founders are the targets of subpoenas contemplated by the Subpoena and Service Motions. Debtor had three directors: Davies, Zhu, and Mark James Dubois, a BVI resident. (*Id.*)

The Supplemental Crumpler Declaration sets forth information about very substantial business conducted by Davies and Zhu on behalf of the Debtor in the United States, making the discovery the Foreign Representatives are seeking from Davies and Zhu particularly relevant. The Supplemental Crumpler Declaration establishes a strong nexus between Davies and Zhu and the Debtor's U.S.-focused business.

Davies and Zhu formed Three Arrows Capital, LLC in Delaware, and registered it to operate in the State of California as Three Arrows Capital Management, LLC. (Supplemental Crumpler Decl. ¶ 7.) Davies and Zhu incorporated Three Arrows Capital, Ltd. in the British Virgin Islands. (*Id.*) The Founders obtained credit from U.S. financial institutions including JPMorgan Chase, Citibank, and Bank of America. (*Id.* ¶ 8.)

In a December 3, 2022 interview, Davies stated that he and Zhu ran the firm together and built everything in-house themselves, and personally performed every role at the firm, including trade executions, operations, human resources, and risk assessments. (*Id.*) They conducted the Debtor's business via Three Arrows Capital Pte. Ltd. (a Singapore entity and the Debtor's immediate parent) and Three AC Ltd. (a BVI entity) that acted as the Debt-

or's former and current investment managers, respectively (and collectively referred to as "Investment Managers"). (*Id.* ¶ 11; Service Motion ¶ 21.) Davies and Zhu own 100% equity in Three Arrows Capital Pte. Ltd.; Zhu and Davies' wife own 100% equity in Three AC Ltd. (Supplemental Crumpler Decl. ¶ 11.) Davies and Zhu controlled the Investment Managers, which made investment decisions, managed the Debtor's feeder funds, and generally engaged in day-to-day management activities on behalf of the Debtor. (*Id.*) The Foreign Representatives state that in 2021, Debtor's Investment Manager changed from Three Arrows Capital Pte. Ltd. in Singapore to Three AC Ltd. in the BVI. (*Id.*)

The Foreign Representatives claim that Davies and Zhu executed hundreds of millions of dollars in funding deals in and/or with numerous American cryptocurrency, blockchain, and fintech companies, including Aptos Labs, dYdx, and BlockFi. (*Id.* ¶ 12.) These deals included a syndicate of investors, many of which were based in New York and California, and many of the loan contracts are governed by New York venue and choice of law provisions. (*Id.* ¶ 14.) Davies and Zhu, on behalf of the Debtors, also contracted with U.S. service providers such as BitGo, an auditing service provider located in California. (*Id.* ¶ 15.)

There is no doubt based on this supplemental information that discovery from Davies and Zhu is appropriate in this Chapter 15 case.

B. BVI Proceeding

The Debtor's business collapsed in the wake of extreme fluctuations in cryptocurrency markets. (Crumpler Decl. ¶ 17.) On June 27, 2022, the Debtor commenced a liquidation proceeding before the Eastern Caribbean Supreme Court in the High Court of Justice Virgin Islands (Commercial Division) (the "BVI Court") captioned *In re Three Arrows Capital Limited*, Case No. BVIHCOM2022/0119 (June 27, 2022). (*Id.* ¶¶ 23–25.) The BVI Court appointed the Foreign Representatives as joint liquidators of the Debtor. (*Id.* ¶ 26).

C. The Chapter 15 Case

On July 1, 2022, the Foreign Representatives commenced this Chapter 15 Case. ("Petition," ECF Doc. ## 1, 2.) Shortly after commencing this case, the Foreign Representatives filed a motion seeking certain provisional relief on July 8, 2022 ("Provisional Relief Motion" ECF Doc. # 22) with a focus on controlling and preserving the Debtor's assets. The Provisional Relief Motion was granted by order entered on July 12, 2022. ("Provisional Relief Order," ECF Doc. # 32.) Among other relief, the Provisional Relief Order authorized the Foreign Representatives:

> to issue subpoenas (a) with respect to the Founders, for the production of documents and deposition[s] ... and (b) [upon] any other persons or entities that the Foreign Representatives reasonably determine during the course of their investigation may have information relevant to the Debtor, its affairs, or its assets.

(Subpoena Motion ¶ 8 (quoting Provisional Relief Order ¶ 4).)

On July 28, 2022, the Bankruptcy Court entered the Order Granting Recognition of Foreign Main Proceeding and Related Relief ("Recognition Order," ECF Doc. # 47), granting the relief sought by the Petition, including recognition of the BVI Proceeding as a foreign main proceeding and recognition of the Foreign Representatives as "foreign representatives," as defined in section 101(24) of the Bankruptcy Code. (Recognition Order ¶¶ 2–3.) The Recognition Order also extended the relief granted

by the Provisional Relief Order, which was limited to the service of the form of subpoena attached to the Provisional Relief Order. (Subpoena Motion ¶ 10 (citing Recognition Order ¶ 13).)

D. Discovery Efforts to Date

The Subpoena and Service Motions detail the Foreign Representatives' attempts to obtain information in the case thus far to identify and preserve Debtor's assets. The Foreign Representatives claim they have engaged with numerous parties including banks, cryptocurrency exchanges, brokers, etc., and that they have used formal discovery tools pursuant to the Provisional Relief Order to, *inter alia*, issue eighteen subpoenas to such parties. (Subpoena Motion ¶¶ 14–15.) They have also attempted to obtain discovery from the Founders and related entities as discussed below.

1. The Founders

The Foreign Representatives claim that they have been unable to obtain sufficient information from the Founders through informal and formal means. With respect to formal means, the Foreign Representatives claim that they have been unable to serve subpoenas on the Founders as their whereabouts are unknown. (*Id.* ¶ 16.) They also claim that Advocatus Law LLP ("Advocatus"), a law firm that purported to represent the Founders as Singapore counsel in the past, has declined to accept service on their behalf. (*Id.* ¶ 17.)

The Foreign Representatives also state that informal interactions with the Founders and their counsel leading up to the attempt to serve a subpoena have failed to yield sufficient information. A summarized timeline of their interactions during the summer of 2022 is provided below:

- Late June: The Foreign Representatives contacted the Founders' BVI and Singapore counsel requesting an immediate meeting. (Service Motion ¶ 13.)
- July 6: Advocatus emailed the Foreign Representatives denying an immediate meeting, but offering an introductory Zoom call. (*Id.*)
- July 8 (Approximately): An introductory Zoom call was held between Foreign Representatives, Advocatus, and Solitaire LLC (Singapore counsel to Founders, "Solitaire"), and presumably the Founders; a "Kyle" and "Su Zhu" were present on the Zoom call, their video was turned off and they were on mute at all times with neither of them speaking despite questions being posed to them directly. The Foreign Representatives requested immediate access to the Debtor's offices and certain basic information regarding the Debtor's bank accounts and digital wallets and were told that Advocatus would discuss with the Founders and hoped to provide certain information in response at a subsequent meeting, which was later cancelled by the Founders. (*Id.* ¶ 14.)
- Throughout July (After the July 8 Meeting): The Foreign Representatives exchanged emails between their counsel and Advocatus requesting specific information regarding the Debtor's assets and for cooperation in obtaining access to them; Advocatus repeatedly represented the Founders' willingness to cooperate. Specifically, the Founders agreed to cooperate in the turning over of seed phrases in Kyle Davies's safe deposit box, providing a complete list of assets, and the removal/transfer of two factor authentication critical accounts and documents. Rather than making good faith efforts to cooperate, the Founders chose to offer excuses for

their non-compliance and to repeatedly avoid meetings with the Foreign Representatives to discuss the same. (*Id.* ¶ 15.)

- Late July: The Founders saw fit to speak "extensively" with Bloomberg regarding the Debtor's collapse and the ongoing liquidation proceeding. (*Id.* ¶ 17.)
- Early August 2022 (Approximately): The Founders had only provided the Foreign Representatives with an incomplete list of assets and accounts, and the Founders continued to withhold information necessary to take control of the limited assets and accounts that had been disclosed. (*Id.* ¶ 16.)
- August 11, 2022: The Founders agreed to attend another Zoom meeting with the Foreign Representatives so long as Advocatus could be present. At this meeting, the Foreign Representatives provided a list of high-priority information requests, and Mr. Zhu indicated he would respond accordingly. (*Id.* ¶ 17.)
- August 26, 2022: At the Foreign Representatives' request, they had a second meeting with the Founders and Advocatus. The Foreign Representatives requested the outstanding information; however, Advocatus limited the conversation to transferring electronic access for certain cryptocurrency exchanges and expressed the Founders' reluctance for discussing the outstanding information requests at that time. (*Id.* ¶ 18.)

In addition to the discussions with the Founders, the Foreign Representatives have been provided with email addresses, which they have been told can be used to send specific inquiries directly to the Founders. (Subpoena Motion ¶ 20.) The Foreign Representatives have sent several inquiries to these email addresses, and have yet to receive any response, save for responses through Advocatus on October 7, 2022 to emails sent by the Foreign Representatives regarding recovery passcodes and private keys to access certain digital wallets. (*Id.*)

Overall, the Foreign Representatives claim that their attempts at communication with the Founders and counsel have not yielded adequate information, and that they have only received an incomplete list of Debtor's assets. (*Id.* ¶¶ 20–21.) Likewise, the Founders have refused to cooperate with the Foreign Representatives' efforts to gain access to the Debtor's books and records in their possession. (*Id.*) In addition to selective disclosure of the Debtor's assets, the Foreign Representatives also have reason to believe that the Founders have continued to withhold "seed phrases" and other information in their possession that are essential to accessing and controlling certain of the Debtor's digital assets. (*Id.*)

In sum, since the introductory Zoom call, the Foreign Representatives have communicated with the Founders' counsel via letters, email, and virtual conferences—albeit to no avail. The Founders continue to conceal their whereabouts and have failed to cooperate with the Foreign Representatives in a sufficient manner, including via the Founders' counsel. (Service Motion ¶ 19.)

2. Investment Managers and Other Parties

Notwithstanding the above, the Foreign Representatives claim that they have been diligently trying to obtain information elsewhere. (*Id.* ¶ 20.) To that end, Debtor's request for relief in the instant motions is also directed at the Investment Managers, Three Arrows Capital Pte. Ltd. (a Singapore entity and the Debtor's immediate

parent) and Three AC Ltd. (a BVI entity). (*Id.* ¶ 21.)

The Foreign Representatives claim that the Investment Managers possess critical information regarding the Debtor's assets and affairs. (*Id.* ¶ 22.) Namely, the Foreign Representatives believe that the Founders control the Investment Managers, which made investment decisions, managed the Debtor's feeder funds, and generally engaged in day-to-day management activities on behalf of the Debtor. (*Id.*) Consequently, the Foreign Representatives claim that the Investment Managers have access and means to control the Debtor's accounts with cryptocurrency exchanges and brokerages and possess valuable discoverable information regarding the Debtor's assets and affairs. (*Id.*) This information bears directly on the location and viability of the Debtor's assets and the causes of the Debtor's insolvency. (*Id.*) Accordingly, obtaining access to such documents and information is critical to marshalling and preserving the Debtor's assets and furthering the Foreign Representatives' investigation. (*Id.*)

The Foreign Representatives have engaged with Solitaire, Singapore counsel purporting to represent at least one of the Investment Managers and which has in the past represented itself as counsel to the Founders. (*Id.* ¶ 23.) The Foreign Representatives requested information and documents pertaining to the Debtor in the Investment Managers' possession and control. (*Id.*) While they partially complied, the Foreign Representatives believe the Investment Managers are withholding relevant and valuable information relating to the Debtor. (*Id.*)

Finally, the Foreign Representatives note that other attempts to serve third parties have been similarly unsuccessful. For instance, the Foreign Representatives requested certain financial and account information from Troy Trade, a prime broker of the Debtor that advertises itself as specializing in crypto trading and asset management. (*Id.* ¶ 25.) The Foreign Representatives have only received partial compliance via disclosure of seed phrases for certain wallets and are unable to ascertain where Troy Trade is based, (other than ostensibly being located in Beijing, China). (*Id.*)

E. Related Foreign Proceedings

The Foreign Representatives report that they commenced a proceeding in the High Court of Singapore (the "Singapore Court") for recognition of the BVI Proceeding as a foreign main proceeding (the "Singapore Proceeding"). Relevant orders in the Singapore Court have been entered as follows:

- July 15, 2022: Granting provisional relief, including the power to compel the cooperation of individuals within the jurisdiction of the Singapore Court.
- August 22, 2022: Granting recognition of the BVI Proceeding as a foreign main proceeding in Singapore.
- September 19, 2022: Requiring all persons and entities located in Singapore to cooperate with the Foreign Representatives in respect of the liquidation.

(Subpoena Motion ¶ 11.)

The Foreign Representatives note that they will be seeking certain discovery from Three Arrows Capital Pte. Ltd., a Singapore entity and Debtor's former Investment Manager, in that proceeding. (*Id.*) This discovery ostensibly has some overlap with what is sought from the Former Investment Manager and related individuals/entities as part of the Subpoena and Service Motions, as further discussed below. The Foreign Representatives also

stated that they have filed an application for recognition of the BVI Proceeding as a foreign main proceeding in the Superior Court of Justice in Ontario, Canada, and that they intend to do the same in the Supreme Court of Seychelles very shortly. (*Id.* ¶ 12.)

F. Procedural History of the Service & Subpoena Motions

The Foreign Representatives filed the Subpoena and Service Motions, along with other motions for relief not at issue here. A hearing was held on both motions on December 2, 2022. (*See generally*, Hr'g Tr., December 2, 2022, ECF Doc. # 77, at 8:3–13.)

The Subpoena Motion was directed at supporting the scope of the Foreign Representatives' proposed subpoenas, while the Service Motion, as the name implies, sought authorization to serve the subpoenas via alternative means. At the hearing, the Court was satisfied that the scope of the subpoenas and relief sought in the Subpoena Motion was appropriate under the relevant Bankruptcy Code provisions and Bankruptcy Rules.[1] The Court was not satisfied on the record then presented that the Service Motion could be granted. The Court said that the Service Motion raised factual questions pertaining to the Founders' nationalities and residences that implicated whether they could be served pursuant to Federal Rule of Civil Procedure 45. (Hr'g Tr., December 2, 2022, 30:11–20.) Instead of denying the Service Motion outright, the Court reserved decision and afforded the Foreign Representatives the opportunity to make supplemental legal and factual submissions (*see id.* 45:1–11), which the Foreign Representatives filed on December 13, 2022. (*See* Supplemental Brief; Supplemental Crumpler Decl.) In relevant part, the Foreign Representatives' supplemental submissions included relevant facts pertaining to the Founders' nationalities and residences.

The Foreign Representatives claim that Davies was born in the United States and, therefore, is a United States citizen by birth. (Supplemental Crumpler Decl. ¶ 5.) Additionally, the Debtor's Register of Directors filed with the BVI Financial Service Commission lists Davies as being born in the United States and his nationality as American. (*Id.*) The Foreign Representatives do not know whether Davies has formally renounced his U.S. citizenship under U.S. law, but they note that a subsequent listing of Davies in the Register of Directors identifies him as Singaporean and that Davies holds Italian and Singaporean passports that were issued in 2017 and 2021, respectively. (*Id.*)

The Foreign Representatives claim that Zhu was born in China. (*Id.* ¶ 6.) He moved to the United States, attended high school in Massachusetts and college in New York, and lived in San Francisco in 2012. (*Id.*) Therefore, the Foreign Representatives argue, in order to have legally resided in the United States, at a minimum, Zhu had a U.S. Visa. Zhu holds a Singaporean passport, which was issued in 2020. (*Id.*) In addition, the Debtor's Register of Directors filed with the BVI Financial Service Commission lists Zhu as Singaporean. (*Id.*)

II. ANALYSIS

The Foreign Representatives' Service Motion implicates issues regarding the scope of Federal Rule of Civil Procedure 45 ("Rule 45"), and alternative service of process under Rule 45. The issues are addressed in turn. In sum, the Foreign Representatives fail to show that Rule 45 supports issuance of subpoenas to Zhu, the

1. *See* "Order Granting the Subpoena Motion," ECF Doc. # 71.

Investment Managers, and Troy Trade; the Service Motions are **DENIED** as to those parties. The Foreign Representatives do, however, show that Rule 45 supports issuance of a subpoena against Davies, and the Foreign Representatives also show that their proposed manner of alternative service is warranted here. Therefore, the Service Motion is **GRANTED** with respect to Davies.

A. Scope of Rule 45

The Foreign Representatives seek to serve all subpoenas pursuant to Rule 45 outside the United States. Whether service of the subpoenas would be appropriate pursuant to Rule 45 then depends in part on facts regarding the intended subpoena recipients' citizenship and residence. Those facts were unclear from the Foreign Representatives' original submissions on the Subpoena and Service Motions. At the hearing on the Foreign Representatives' original submissions, the Court ordered the Foreign Representatives to make additional submissions regarding, *inter alia*, these facts, as well as any supplemental legal authority supporting their Subpoena and Service motion. With that background established, the Court turns to the relevant authorities. Rule 45(b) explicitly authorizes service in one of two ways:

> (2) Service in the United States. A subpoena may be served at any place within the United States.
>
> (3) Service in a Foreign Country. 28 U.S.C. § 1783 governs issuing and serving a subpoena directed to a United States national or resident who is in a foreign country.

FED. R. CIV. PROC. 45(b)(2)–(3).

Rule 45 does not explicitly allow for service of persons outside the United States that are not United States nationals or residents. Thus, the analysis below is separated between the intended subpoena recipients that are United States nationals or residents, and those that are not.

1. Non-United States Nationals and Residents: Investment Managers and Zhu

[1] Here, the Foreign Representatives seek express authorization to serve subpoenas on four different parties that do not appear to be United States nationals or residents, and are located in foreign countries: Zhu, the two Investment Managers, and Troy Trade. The issue is whether the language of Rule 45(b)(3) allows for service on such parties.

As discussed above, Rule 45(b)(3) only addresses service of a subpoena "directed to a United States national or resident who is in a foreign country." FED. R. CIV. PROC. 45(b)(3). The Foreign Representatives effectively advance two arguments why Rule 45 nevertheless permits service. Both lack merit.

a. Rule 45 is Not "Silent"

The Foreign Representatives first characterize Rule 45 as "silent" on foreign service of non-nationals and non-residents. The Foreign Representatives claim that analogizing to Federal Rule of Civil Procedure 4, which governs service of summonses and allows for service on foreign parties outside the United States, is appropriate in light of Rule 45's silence. There are multiple problems with this argument.

First, other courts addressing this issue have clearly held that Rule 45 is not just "silent" on foreign service of non-nationals and non-residents, but it provides an explicit limit on such service. *NML Capital Ltd. v. Republic of Arg.*, 2014 WL 3898021, at *9 (D. Nev. Aug. 11, 2014) (stating that "the only people who cannot be served under Rule 45 are foreign nationals residing in a foreign country"). Other cases have reached the same conclusions for foreign entities. *See SiteLock, LLC v. GoDad-*

dy.com, LLC, 338 F.R.D. 146, 148 (D. Or. 2021) ("[A] foreign corporation 'is not a United States national or resident and therefore cannot be served with a subpoena under Rule 45.' ") (quoting *Viasat, Inc. v. Space Sys./Loral, LLC*, 2014 WL 12577593, at *5 (S.D. Cal. June 30, 2014)). Courts in this district have reached the same conclusion, and disposed of similar arguments that Rule 45(b)(3) somehow implicitly allows for service of non-citizens outside the United States:

> It is unclear what, if any, provision of the Federal Rules [Subpoenaing Party] believes controls the service of subpoenas directed at foreign nationals living abroad. If [Subpoenaing Party] were correct, and 45(b)(3) was not relevant to the service of subpoenas on foreign nationals living abroad, it strains credulity to believe that this apparent silence in the Rules would result in the unlimited ability of litigants to serve trial subpoenas on any foreign national anywhere in the world, especially considering the more stringent limitations on serving United States nationals living aboard. In any event, courts faced with similar circumstances have found that foreign nationals living abroad are not subject to subpoena service outside the United States.

Aristocrat Leisure Ltd. v. Deutsche Bank Tr. Co. Americas, 262 F.R.D. 293, 305 (S.D.N.Y. 2009).

The Foreign Representatives do not cite a single case where a court has found service on a non-national or non-resident outside the United States to be acceptable under Rule 45.

For that reason alone, the Court rejects the Foreign Representatives' argument that the Court should resort to Rule 4 by analogy to address Rule 45's "silence." If anything, the fact that Rule 4 was drafted to include explicit language providing for service of any "individual . . . at a place not within any judicial district of the United States," FED. R. CIV. P. 4(f), weighs against the Foreign Representatives' arguments that the clearly worded language of Rule 45 does not operate as a geographic limitation. Moreover, the Foreign Representatives only cite to a single case for the notion that service under Rule 4 informs service of foreign nationals under Rule 45. *See In re Procom Am., LLC*, 638 B.R. 634, 644 (Bankr. M.D. Fla. 2022). And while *Procom* did involve service of a subpoena on a non-resident alien residing in another country, that service was made in the United States on the non-resident's lawyer, which is clearly within the purview of Rule 45(b)(2). *Id.* at 642-43. Thus, *Procom* does nothing to address the instant issue here regarding service *outside* the United States under Rule 45(b)(3).

b. Alternative Service is Not Appropriate

The Foreign Representatives' second argument is only a slight variation on the first, as it again relies on comparisons of service under Rule 4 to legitimize service under Rule 45. But instead of arguing that Rule 4 informs Rule 45 in light of the latter's "silence," the Foreign Representatives argue that their proposed methods meet standards for "alternative" service under Rule 4, and Rule 45 by analogy.

The Foreign Representatives' argument proposes that because service pursuant to Rule 4 and Rule 45 must both be "reasonably calculated" to provide notice to the intended recipient, *see Procom*, 638 B.R. at 644, that certain alternative methods found to be reasonably calculated to do so in the Rule 4 context are permissible in the Rule 45 context. The Foreign Representatives then point to a significant number of cases allowing for alternative service via email or

social media pursuant to Rule 4,[2] and argue that this justifies the same methods of service for a subpoena pursuant to Rule 45.

The Court does not find it to be controversial that Rule 4 cases applying the "reasonably calculated" standard, which is a due process requirement, can be instructive in the Rule 45 context. In fact, the Court finds Rule 4 caselaw persuasive with respect to service on Davies, as discussed *infra*. Nevertheless, this argument still misses the point in addressing the territorial statutory limitations in Rule 45 identified above. Put differently, the Foreign Representatives attempt to show that they are entitled to "alternative" service, without showing that they have a statutory basis for "standard" service under Rule 45 in the first instance. That stands in contrast to any Rule 4 case the Foreign Representatives cite, because the language of Rule 4 explicitly allows for service abroad. *See* FED. R. CIV. P. 4(f). And glaringly, the Foreign Representatives fail to put forth any cases that directly support "alternative" service of a subpoena outside the United States in the manner proposed, whether by analogy to Rule 4 or otherwise.

Ultimately, what the Foreign Representatives seek via "alternative" service is an alternative to Rule 45 itself. But the applicable caselaw permitting "alternative" service involves service via means that provide a comparable alternative to standard methods, where factual circumstances prevent standard service. Here, service on parties outside the United States via email or social media would be completely unlike any standard methods of service available to the Foreign Representatives under Rule 45 because there are none. Allowing the Foreign Representatives to serve in this manner under the guise of "alternative" service would create an exception that would render Rule 45's explicit territorial limits meaningless given the ubiquity of email and social media. Indeed, every litigant that wishes to seek discovery from foreign national nonparties outside the United States would likely appreciate some "alternative," but the Court cannot ignore Rule 45's explicit territorial limitations.

2. United States Nationals and Residents: Davies

[2] The Foreign Representatives also seek to serve a subpoena on one of the Founders, Kyle Davies, outside the United States. As a factual matter, the Foreign Representatives' submissions establish that Davies was born in the United States, and as a result, the Court presumes that Davies is a United States national. *In re Petrobras Sec. Litig.*, 2016 WL 908644, at *1 (S.D.N.Y. Mar. 4, 2016) (finding that witness born in the United States was a citizen and national in applying Rule 45(b)(3)). Therefore, Rule 45(b)(3) will apply, which states that: "28 U.S.C. § 1783 governs issuing and serving a subpoena directed to a United States national or resident who is in a foreign country."

In turn, 28 U.S.C. § 1783 reads:

> A court of the United States may order the issuance of a subpoena requiring the appearance as a witness before it, or before a person or body designated by it, of a national or resident of the United

2. *See, e.g., Hardin v. Tron Found.*, 20-CV-2804, 2020 WL 5236941, at *1 (S.D.N.Y. Sept. 1, 2020) (allowing service via email and social media); *In re Bibox Group Holdings Limited Securities Litigation*, 2020 WL 4586819, at *3 (S.D.N.Y. Aug. 10, 2020) (allowing service via email and social media); *Advanced Access Content Sys. Licensing Adm'r, LLC v. Shen*, No. 14-CV-1112, 2018 WL 4757939, at *13 (S.D.N.Y. Sept. 30, 2018) (allowing service via email); *Rio Props., Inc. v. Rio Int'l Interlink*, 284 F.3d 1007, 1014 (9th Cir. 2002) (allowing service via email).

> States who is in a foreign country, or requiring the production of a specified document or other thing by him, if the court finds that particular testimony or the production of the document or other thing by him is necessary in the interest of justice, and, in other than a criminal action or proceeding, if the court finds, in addition, that it is not possible to obtain his testimony in admissible form without his personal appearance or to obtain the production of the document or other thing in any other manner.

28 U.S.C. § 1783.

Thus, since this is not a criminal action or proceeding, the issues become whether production of the documents are: (1) necessary in the interests of justice; and (2) not possible to obtain in any other manner.

[3] First, the Court finds that the discovery sought from Davies is necessary and "in the interests of justice," such that is satisfies the first requirement of section 1783(a). Initially, the Court notes that it faces a unique situation with respect to this necessity prong, as most of the civil cases applying section 1783 do so in instances where the discovery sought is in connection with pending causes of action, and the necessity is measured by relation to those causes of action. *See Balk v. N.Y. Institute of Tech.*, 974 F. Supp. 2d 147, 156–57 (E.D.N.Y. 2013) (finding that discovery is necessary under section 1783 where it "bears directly on the key issues in th[e] case"). Here, however, the Foreign Representatives seek the discovery as part of motion made pursuant to Federal Rule of Bankruptcy Procedure ("Bankruptcy Rule") 2004, which provides a freestanding mechanism for discovery regarding the Debtor's estate, that need not be brought in connection with any pending causes of action.[3] *See generally* FED. R. BANKR. P. 2004.

[4, 5] Procedural posture aside, the facts here show that the discovery sought is necessary under section 1783. First, Davies played a paramount and "integral role" in the Debtor's organization. *Balk*, 974 F.Supp.2d at 157–58. Based on the Foreign Representatives' submissions, Davies was one of the Debtor's two founders, and since its inception, ran all facets of the business with Zhu. This level of responsibility within the organization that is the focus of the main action clearly shows that Davies has knowledge of information that is necessary for the Foreign Representatives to obtain. *See Petrobras*, 2016 WL 908644, at *1 (granting section 1783 motion seeking discovery from director and audit committee member of company that was at center of alleged bribery and kickback scheme). Moreover, one of the key purposes of Bankruptcy Rule 2004 discovery is to allow those representing or administering a debtor's estate to ascertain the extent of the debtor's liabilities and assets. Davies and Zhu might arguably be the only parties with knowledge regarding the nature, extent, and access to the Debtor's assets, particularly as they are connected to the United States in this Chapter 15 case. The discovery from Davies is undoubtedly necessary in connection with the

3. There is no "estate" in a Chapter 15 case. As explained in *In re Berau Capital Resources Pte. Ltd.,* 540 B.R. 80, 83 (Bankr. S.D.N.Y. 2015), "[u]pon an order recognizing a proceeding as a foreign main proceeding, section 1520 makes sections 361 and 362 applicable with respect to the debtor and property of the debtor within the jurisdiction of the United States. The statute refers to 'property of the debtor' to distinguish it from the 'property of the estate' that is created under section 541(a). In a chapter 15 case, there is no 'estate'; nevertheless, section 1520(a) imposes an automatic stay on any action with respect to the debtor's property located in the United States."

Bankruptcy Rule 2004 discovery in this Chapter 15 case.[4]

[6] "In assessing the second prong—whether there are potentially alternative methods to obtain testimony—courts analyze whether it is practical to obtain the information sought from the witness." *Balk*, 974 F.Supp.2d at 156. "Sheer impossibility is not required." *Id.* (citation omitted). The Foreign Representatives have shown that the discovery sought is likely not obtainable via other means here.

First, the Foreign Representatives aver that they have taken all reasonable steps to obtain discovery from parties that conducted business with the Debtor in the United States to cobble together as much information as possible about the estate. But the Court agrees with the Foreign Representatives that it is not reasonable to expect that they could obtain all necessary information about the Debtor's estate simply by conducting discovery with Debtor's third-party business counterparts. As previewed under the first requirement of section 1783(a), the necessary information for purposes of the Bankruptcy Rule 2004 discovery in this case is likely only possessed by Davies and Zhu, and the Court has already determined that discovery is not available from Zhu. Thus, Davies is the only source of the necessary information. The remainder of the obtainability issue then becomes whether there are other avenues for reaching Davies for this discovery. Courts in this district have considered the possibility of obtaining discovery in proceedings in other jurisdictions as relevant in this analysis. *See Petrobras*, 2016 WL 908644, at *1–2. The Court acknowledges that there are other parallel proceedings in other jurisdiction that relate to the Debtor and its assets. The Court considers it likely that those parallel proceedings might also be used to obtain *some* discovery from Davies. That does not mean, however, that the information sought by the Foreign Representatives *in these proceedings* will be obtainable via those proceedings. Indeed, counsel for the Foreign Representatives has been quite clear with the Court that its goals in the Chapter 15 case are to both investigate and marshal assets that have some connection to the United States:

> But to be clear, we take no position . . . as to where the legal situs of digital assets should be, whether in the United States or elsewhere, by virtue of them being held by an institution that oper-

4. Additionally, the Court may order the production of documents from outside the United States. *See In re Markus*, 607 B.R. 379 (Bankr. S.D.N.Y. 2019), *aff'd in part, vacated in part, remanded sub nom. Markus v. Rozhkov*, 615 B.R. 679 (S.D.N.Y. 2020). As *Markus* explains:

> Rule 45's subpoena power is not limited to the production of documents located within the United States. *See Sergeeva v. Tripleton Int'l Ltd.*, 834 F.3d 1194, 1200 (11th Cir. 2016) ("The only geographical limitation provided by Rule 45 concerns the location for the act of production-not the location of the documents or information to be produced."); *Tiffany (NJ) LLC v. Qi Andrew*, 276 F.R.D. 143, 147–48 (S.D.N.Y. 2011), *aff'd sub nom. Tiffany (NJ) LLC v. Andrew*, No. 10 CIV. 9471 WHP, 2011 WL 11562419 (S.D.N.Y. Nov. 14, 2011) ("If the party subpoenaed has the practical ability to obtain the documents, the actual physical location of the documents—even if overseas—is immaterial.").
>
> Discovery in chapter 15 cases does not change this result. Where parties have argued that the requested discovery lacks a sufficient nexus to the United States because it does not involve the recovery of property in the United States, courts have held that "[r]equests for discovery in chapter 15 need not concern assets in the U.S. to be permissible under § 1521(a)(4)." *In re Millennium Glob. Emerging Credit Master Fund Ltd.*, 471 B.R. [342] at 347 [(Bankr. S.D.N.Y. 2012)].

607 B.R. at 389.

> ates through people in the United States. This is a pretty novel issue that could have a wide variety of implications. So I think this is kind of in the nature of a kind of prophylactic-type motion to ensure that to the extent any assets are deemed to be in the United States at a later time, that authority is in place to transfer those to the BVI for the purposes of an efficient distribution.

(Hr'g Tr., December 2, 2022, at 8:3–13.) And thus, the Court finds it reasonable, and indeed likely, that much of the relevant discovery sought is uniquely obtainable—not just from Davies—but from Davies via the Debtor's connections with the United States.

Finally, the entire discussion above regarding obtainability also assumes that Davies or Zhu would even comply with subpoenas issued in parallel proceedings, which may appear to be wishful thinking based on the Foreign Representatives' argument that the Founders have not cooperated with informal discovery requests. Other courts in this district have considered the lack of cooperation in informal discovery as relevant to the obtainability prong. *Balk*, 974 F. Supp. 2d at 159. In conjunction with the fact that the Foreign Representatives argue that the Founders do not wish to reveal their location for service of process, the Court is comfortable concluding that the discovery sought by the Foreign Representatives here would not necessarily be obtainable via other practicable means.

In sum, the Foreign Representatives have shown that Rule 45 and section 1783 allow for service on Davies outside the United States.

B. Alternative Service

[7] Having established that Rule 45 and section 1783 support the service of a subpoena on Davies in the first instance, the next issue becomes whether the Foreign Representatives are entitled to serve Davies via their proposed "alternative" means—email and social media. (*See* "Proposed Order Granting Service Motion," ECF Doc. # 55-1.)

Federal Rule 45(b) explicitly authorizes service of subpoenas anywhere "within the United States" and to "United States national[s] or resident[s] who [are] in a foreign country." FED. R. CIV. P. 45(b). In either case, Rule 45 requires that a subpoena be served by "delivering a copy to the named person ...." FED. R. CIV. P. 45(b)(1). In other words, Rule 45 only expressly endorses personal service.

District courts in the Second Circuit routinely authorize service via other means besides personal service, i.e., "alternative" service, under Rule 45. In doing so, such courts have recognized that the functional purpose of "requiring delivery 'to the named person' is to 'ensure receipt, so that notice will be provided to the recipient, and enforcement of the subpoena will be consistent with the requirements of due process.'" *Med. Diagnostic Imaging, PLLC v. CareCore Nat.*, LLC, No. 06 CIV. 13516, 2008 WL 3833238, at *2 (S.D.N.Y. Aug. 15, 2008) (quoting 9 MOORE'S FEDERAL PRACTICE § 45.21 (3rd ed. 2008)).

Where alternative service is "reasonably calculated" to provide timely actual notice to the subpoenaed non-party, courts in this circuit have found such service to meet the requirements of Rule 45. *See, e.g., First City, Texas-Houston, N.A. v. Rafidain Bank*, 197 F.R.D. 250, 255 (S.D.N.Y. 2000) (finding that attaching a subpoena to the door and mailing another copy to counsel of record was sufficient, "especially since, as noted, [subpoenaed party] does not deny that it received timely actual notice of the subpoena"); *Cordius Trust v. Kummerfeld*, No. 99 Civ. 3200, 2000 WL 10268, at *2 (S.D.N.Y. Jan. 3, 2000) (holding that

because "alternative service by means of certified mail reasonably insures actual receipt of the subpoena by the witness, the 'delivery' requirement of Rule 45 will be met"); *Cartier v. Geneve Collections, Inc.*, No. CV 2007-0201 (DLI) (MDG), 2008 WL 552855, *1 (E.D.N.Y. Feb. 27, 2008) (stating that " 'delivery' under Rule 45 means a manner of service reasonably designed to ensure actual receipt of a subpoena by a witness, rather than personal service").

As a basic proposition, the Court recognizes that service of process via means other than personal service is quite common in this Circuit. The three narrower issues that the Court considers it must address here are: (1) when alternative service is permissible; (2) what types of alternative service have been recognized as permissible under Rule 45; and (3) to the extent that the Foreign Representatives rely on precedent involving alternative service pursuant to rules other than Rule 45, whether there is an adequate basis for applying those precedents in the context of Rule 45.

[8] Turning to the first issue of *when* alternative service is appropriate, the Foreign Representatives face a hurdle in the caselaw in this district requiring a party seeking leave to serve by alternative means "to demonstrate a prior diligent attempt[s] to personally serve" before permitting alternative service under Rule 45. *Kenyon v. Simon & Schuster, Inc.*, No. 16 MISC. 327, 2016 WL 5930265, at *3 S.D.N.Y. Oct. 11, 2016. That is because, in the strictest sense, the Foreign Representatives have not done so here. However, the caselaw in this district is not entirely consistent in imposing this requirement, and other cases have found that it is not necessary to show prior attempts at standard service before seeking court approval. *See Ultradent Prods., Inc. v. Hayman*, 2002 WL 31119425, at *4 (S.D.N.Y. Sept. 24, 2002) (service by certified mail was sufficient even when party did not move for an order authorizing substitute service in advance of service). The Court considers that whether prior diligent attempts are required will depend on the circumstances of each case and the reasons why alternative service is sought.

Here, the absence of any prior attempts to serve by the Foreign Representatives does not appear to be for lack of effort or diligence. The Foreign Representatives explain that they would effectively not know where to begin with a traditional attempt at service, given that the Founders have moved between various countries, concealed their locations, and do not appear to be amenable to service via other avenues, like counsel or a registered agent in the United States.[5] The Court considers that requiring a "diligent prior attempt" at service here would be futile based on the Foreign Representatives' submissions, and the absence of evidence showing that a futile attempt was made before the Foreign Representatives filed their Service Motion is not a bar to the relief they seek here.[6]

5. The Foreign Representatives do propose to serve counsel for the Founders, Advocatus. (*See* Service Motion ¶ 4.) However, the Foreign Representatives acknowledge that Advocatus is Singapore counsel, and states nothing alleging that they would be served within the United States. Thus, service on Advocatus would not comply with the territorial limitations of Rule 45 as discussed *supra*, and it cannot serve as an "alternative" means for that reason.

6. In any event, the Foreign Representatives' proposed order granting the Service Motion states that the Foreign Representatives will first attempt personal service on individuals before resorting to email and social media. (*See* "Proposed Order Granting Service Motion," ECF Doc. # 55-1.)

[9] The second issue for the Foreign Representatives here is showing that the type of alternative service sought—via email and social media—will provide notice in a manner consistent with the other forms of service endorsed in the caselaw. When condoning alternative forms of service under Rule 45—like service via certified mail—courts in this district have relied on the reasoning that such forms "reasonably insure[ ] actual receipt." *See Cordius*, 2000 WL 10268 at *2; *see also Ultradent Prods.*, 2002 WL 31119425, at *4. But functionally, there are legitimate questions as to whether service via email and social media similarly provide evidence of actual receipt, or are effectively so difficult for a party like Davies to ignore that they can be considered to give notice.[7] Given that concern, it is significant that the Foreign Representatives cite only one case where a party was permissibly served via email, and even then, it was effectively used as a "backup" to more widely endorsed methods, like certified mail.[8] This Court was only able to locate one additional case where service of a subpoena via email was permitted, and again, it was used as a backup to personal service, in conjunction with overnight mail. *See Petrobras*, 2016 WL 908644, at *1–2.

This second issue leads to a third—which is whether the Court should consider caselaw for alternative service of process outside the context of Rule 45 instructive here. Because at bottom, the Foreign Representatives' only support for the adequacy of alternative service of process via email or social media is in the context of Rule 4 service. And to the Foreign Representatives' credit, they do cite a number of persuasive cases where process was permitted to be served via email or social media in the context of service pursuant to Rule 4.[9] Moreover, many of these cases permitted service via email or social media as the sole methods of service. This is unlike the *Pence* and *Petrobras* cases in the Rule 45 context, where email service was permitted in conjunction with more widely accepted methods of alternative service. *See Pence*, 322 F.R.D. at 453; *Petrobras*, 2016 WL 908644, at *1–2.

The Court is convinced that alternative service via email and Twitter would be warranted and reasonably calculated to provide notice. First, the Court finds it

7. Just as courts have done with other forms of alternative service, even in the context of email or social media, the Court would not reject any factual indicia of actual receipt to the extent it exists following service. *See, e.g., First City, Texas-Houston, N.A. v. Rafidain Bank*, 197 F.R.D. 250, 255 (S.D.N.Y. 2000) (finding that attaching a subpoena to the door and mailing another copy to counsel of record was sufficient, "especially since, as noted, [subpoenaed party] does not deny that it received timely actual notice of the subpoena").

8. That case also contained much stronger facts showing prior diligent attempts, and the likelihood of receipt by the subpoenaed party. *S.E.C. v. Pence*, 322 F.R.D. 450, 453 (S.D.N.Y. 2017) (concluding that substituted service of subpoena on corporate attorney by e-mail, fax, certified mail, and voicemail message, was appropriate where subpoenaing party had already attempted personal service on attorney 14 times at five locations, and attorney refused to consent to alternative service and registered the telephone number and e-mail address to be used with state bars of which he was a member and had responded to contact by these means in the past).

9. *See, e.g., Hardin v. Tron Found.*, 20-CV-2804, 2020 WL 5236941, at *1 (S.D.N.Y. Sept. 1, 2020) (allowing service via email and social media): *In re Bibox Group Holdings Limited Securities Litigation*, 2020 WL 4586819, at *3 (S.D.N.Y. Aug. 10, 2020) (allowing service via email and social media); *Advanced Access Content Sys. Licensing Adm'r, LLC v. Shen*, No. 14-CV-1112, 2018 WL 4757939, at *13 (S.D.N.Y. Sept. 30, 2018) (allowing service via email); *Rio Props., Inc. v. Rio Int'l Interlink*, 284 F.3d 1007, 1014 (9th Cir. 2002) (allowing service via email).

notable that the Foreign Representatives propose to serve via email to the email addresses that the Founders provided to the Foreign Representatives for the purpose of fielding informal discovery questions. (Subpoena Motion ¶ 20.) Additionally, this conclusion is also informed by the fact that the Foreign Representatives included facts showing recent and actual use of both the Twitter and email accounts. (Service Motion ¶¶ 45–46.) Other courts have considered the extent of the subpoena target's use of social media accounts in considering whether service via those accounts would be reasonably calculated to provide adequate notice. *See St. Francis Assisi v. Kuwait Finance House*, 2016 WL 5725002, at *2 (N.D. Cal. Sept. 30, 2016). The Court also notes that the Twitter use appears to be somewhat public, and the continued use of public Twitter accounts could ostensibly provide probative evidence of actual receipt of the subpoenas.

The Court agrees with the Foreign Representatives that the caselaw regarding Rule 4 is persuasive, if not controlling, here. First, and unlike the Foreign Representatives' prior attempt to analogize to Rule 4, the Foreign Representatives are no longer requesting the Court to apply Rule 4 precedent to bypass the statutory requirements of Rule 45. Instead, the Foreign Representatives argue that cases in which service via email or social email was "reasonably calculated" to provide notice in the Rule 4 context are instructive in the Rule 45 context, because the "reasonably calculated" standard derives from the underlying due process requirement applicable under both rules. *See Procom*, 638 B.R. at 643–44. The Court agrees. Where all other statutory prerequisites are met, and all that remains is the due process standard, the Court finds no principled reason for denying the applicability of the Rule 4 alternative service cases to the Rule 45 context.

In addition to the commonality under the due process standard, there is also a statutory basis for applying Rule 4 and its caselaw here. Because proposed service of Davies implicates Rule 45(b)(3), the Court must also apply section 1783, as discussed above. And section 1783 states that service "shall be effected in accordance with the provisions of the Federal Rules of Civil Procedure relating to service of process on a person in a foreign country." 28 U.S.C. § 1783. In applying section 1783, courts in this district have taken this to mean that service must not only comply with Rule 45, but Rule 4, which explicitly speaks to service of parties in foreign countries. *See Petrobras*, 2016 WL 908644, at *2. Specifically, Rule 4(f) lays out three subsections for service outside the United States. Subsections 4(f)(1) and 4(f)(2) presume that there is knowledge as to the intended recipient's location, and thus the Court considers that they are not applicable here.[10] Rule 4(f)(3), however, provides a catchall, and states that a party may be served outside the United States "by other means not prohibited by international agreement, as the court orders." FED. R. CIV. P. 4(f)(3). The Court notes that other courts in this district have permitted service of Rule 45 and section 1783 subpoenas by email under Rule 4(f)(3), even when the location of the subpoena recipient was known to the appli-

10. In particular, the Court notes that Rule 4(f)(1), which references service via the Hague convention is inapplicable given that Davies' location is unknown. *Prediction Co. LLC v. Rajgarhia*, No. 09-cv-07459 (SAS), 2010 WL 1050307, *2 (S.D.N.Y. Mar. 22, 2010) ("[I]t is worth observing the inapplicability of the Hague Convention . . . because [the defendant's] address is not known to [plaintiff]"). The Court considers the Rule 4(f)(2) is similarly inapplicable by the same reasoning.

cant and the court. *See Petrobras*, 2016 WL 908644, at *2.

While the lack of caselaw allowing for Rule 45 service via email or social media is curious, this does not seem to be an indication that doing so is incorrect. For one, the Court was equally unavailing in locating any cases where courts *rejected* applications to serve subpoenas via email or social media in the context of Rule 45. Notably, it appears that in the vast majority of Rule 4 cases where service is permitted via email or social media, the service is made outside the United States, on foreign persons or entities.[11] As discussed above, however, Rule 45 only allows for service outside the United States on United States nationals, which the Court has come to understand happens very infrequently in comparison. Thus, the Court considers that it reaches the correct result, albeit in a factually rare circumstance, in allowing for alternative service of a Rule 45 subpoena outside the United States via email and social media.

III. CONCLUSION

For the reasons discussed above, the Service Motion is **GRANTED** with respect to Kyle Davies, and **DENIED** with respect to all other parties.

IT IS SO ORDERED.

11. *See, e.g., In re Bibox Group Holdings Limited Securities Litigation*, 2020 WL 4586819, at *3 (S.D.N.Y. Aug. 10, 2020) (authorizing service over certain Chinese defendants via, among other methods, ''their social media accounts,'' including Twitter, and ''corporate and personal email''); *Nowak v. XAPO, Inc.*, No. 20-CV-03643, 2020 WL 5877576, at *4 (N.D. Cal. Oct. 2, 2020) (authorizing service on an Indonesian defendant by email and via social media to its Facebook and Twitter accounts); *St. Francis Assisi v. Kuwait Finance House*, 2016 WL 5725002, at *2 (N.D. Cal. Sept. 30, 2016) (authorizing service of process on a Kuwaiti national by Twitter).

IN RE: COMEDYMX, LLC, et al., Debtors.

Case No. 22-11181 (CTG) (Jointly Administered)

United States Bankruptcy Court, D. Delaware.

Signed December 16, 2022

Background: Business rival moved to de-designate subchapter V case to regular Chapter 11 and to appoint Chapter 11 trustee, or alternatively to remove debtors as debtors in possession and to authorize subchapter V trustee to operate debtors' business. The United States Trustee moved to remove debtor in possession or, alternatively, to dismiss jointly administered cases "for cause."

Holdings: The Bankruptcy Court, Craig T. Goldblatt, J., held that:

(1) any authority to override debtor's judgment to proceed under subchapter V had to be exercised only as last resort where no other mechanism was available to achieve objectives of Chapter 11;

(2) owner was poorly suited to fulfill statutory obligation of managing debtor's business as fiduciary to estate and its stakeholders, and therefore cause existed for debtor to not be debtor-in-possession; and

(3) debtor retained right to file plan of reorganization, and efforts to propose plan that was capable of being confirmed had to be exhausted before

TAB 19

In re BlockFi Inc., Case No. 22-19361 (Bank. D. N.J.)

Fill in this information to identify the case:

United States Bankruptcy Court for the:

_____ District of New Jersey
(State)

Case number (*If known*): _____ Chapter 11

☐ Check if this is an amended filing

Official Form 201

Voluntary Petition for Non-Individuals Filing for Bankruptcy 06/22

If more space is needed, attach a separate sheet to this form. On the top of any additional pages, write the debtor's name and the case number (if known). For more information, a separate document, *Instructions for Bankruptcy Forms for Non-Individuals,* is available.

1. **Debtor's name** BlockFi Inc.

2. **All other names debtor used in the last 8 years**
Include any assumed names, trade names, and *doing business as* names
N/A

3. **Debtor's federal Employer Identification Number** (EIN) 82-2390015

4. **Debtor's address**

Principal place of business

201 Montgomery Street, Suite 263
Number Street

Jersey City NJ 07302
City State ZIP Code

Hudson
County

Mailing address, if different from principal place of business

Number Street

P.O. Box

City State ZIP Code

Location of principal assets, if different from principal place of business

Number Street

City State ZIP Code

5. **Debtor's website** (URL) www.blockfi.com

Debtor BlockFi Inc. Case number (*if known*)_____
Name

6. Type of debtor

- ☒ Corporation (including Limited Liability Company (LLC) and Limited Liability Partnership (LLP))
- ☐ Partnership (excluding LLP)
- ☐ Other. Specify: _____

7. Describe debtor's business

A. *Check one:*

- ☐ Health Care Business (as defined in 11 U.S.C. § 101(27A))
- ☐ Single Asset Real Estate (as defined in 11 U.S.C. § 101(51B))
- ☐ Railroad (as defined in 11 U.S.C. § 101(44))
- ☐ Stockbroker (as defined in 11 U.S.C. § 101(53A))
- ☐ Commodity Broker (as defined in 11 U.S.C. § 101(6))
- ☐ Clearing Bank (as defined in 11 U.S.C. § 781(3))
- ☒ None of the above

B. *Check all that apply:*

- ☐ Tax-exempt entity (as described in 26 U.S.C. § 501)
- ☐ Investment company, including hedge fund or pooled investment vehicle (as defined in 15 U.S.C. § 80a-3)
- ☐ Investment advisor (as defined in 15 U.S.C. § 80b-2(a)(11))

C. NAICS (North American Industry Classification System) 4-digit code that best describes debtor. See http://www.uscourts.gov/four-digit-national-association-naics-codes .

5 2 3 9

8. Under which chapter of the Bankruptcy Code is the debtor filing?

A debtor who is a "small business debtor" must check the first sub-box. A debtor as defined in § 1182(1) who elects to proceed under subchapter V of chapter 11 (whether or not the debtor is a "small business debtor") must check the second sub-box.

Check one:

- ☐ Chapter 7
- ☐ Chapter 9
- ☒ Chapter 11. *Check **all** that apply*:
  - ☐ The debtor is a small business debtor as defined in 11 U.S.C. § 101(51D), and its aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than $3,024,725. If this sub-box is selected, attach the most recent balance sheet, statement of operations, cash-flow statement, and federal income tax return or if any of these documents do not exist, follow the procedure in 11 U.S.C. § 1116(1)(B).
  - ☐ The debtor is a debtor as defined in 11 U.S.C. § 1182(1), its aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than $7,500,000, **and it chooses to proceed under Subchapter V of Chapter 11.** If this sub-box is selected, attach the most recent balance sheet, statement of operations, cash-flow statement, and federal income tax return, or if any of these documents do not exist, follow the procedure in 11 U.S.C. § 1116(1)(B).
  - ☒ A plan is being filed with this petition.
  - ☐ Acceptances of the plan were solicited prepetition from one or more classes of creditors, in accordance with 11 U.S.C. § 1126(b).
  - ☐ The debtor is required to file periodic reports (for example, 10K and 10Q) with the Securities and Exchange Commission according to § 13 or 15(d) of the Securities Exchange Act of 1934. File the *Attachment to Voluntary Petition for Non-Individuals Filing for Bankruptcy under Chapter 11* (Official Form 201A) with this form.
  - ☐ The debtor is a shell company as defined in the Securities Exchange Act of 1934 Rule 12b-2.
- ☐ Chapter 12

Debtor BlockFi Inc. Case number (*if known*) _____
Name

9. Were prior bankruptcy cases filed by or against the debtor within the last 8 years?

If more than 2 cases, attach a separate list.

☒ No

☐ Yes. District _____ When _____ Case number _____
MM / DD / YYYY

District _____ When _____ Case number _____
MM / DD / YYYY

10. Are any bankruptcy cases pending or being filed by a business partner or an affiliate of the debtor?

List all cases. If more than 1, attach a separate list.

☐ No

☒ Yes. Debtor See attached Rider Relationship Affiliate

District New Jersey When 11/28/2022
MM / DD / YYYY

Case number, if known _____

11. Why is the case filed in *this district*?

Check all that apply:

☒ Debtor has had its domicile, principal place of business, or principal assets in this district for 180 days immediately preceding the date of this petition or for a longer part of such 180 days than in any other district.

☐ A bankruptcy case concerning debtor's affiliate, general partner, or partnership is pending in this district.

12. Does the debtor own or have possession of any real property or personal property that needs immediate attention?

☒ No

☐ Yes. Answer below for each property that needs immediate attention. Attach additional sheets if needed.

Why does the property need immediate attention? (*Check all that apply.*)

☐ It poses or is alleged to pose a threat of imminent and identifiable hazard to public health or safety.
What is the hazard? _____

☐ It needs to be physically secured or protected from the weather.

☐ It includes perishable goods or assets that could quickly deteriorate or lose value without attention (for example, livestock, seasonal goods, meat, dairy, produce, or securities-related assets or other options).

☐ Other _____

Where is the property? _____
Number Street

_____

_____ _____ _____
City State ZIP Code

Is the property insured?

☐ No

☐ Yes. Insurance agency _____

Contact name _____

Phone _____

Statistical and administrative information

Debtor BlockFi Inc. Case number (*if known*)
Name

13. Debtor's estimation of available funds

Check one:

☒ Funds will be available for distribution to unsecured creditors.
☐ After any administrative expenses are paid, no funds will be available for distribution to unsecured creditors.

14. Estimated number of creditors
consolidated

☐ 1-49	☐ 1,000-5,000	☐ 25,001-50,000
☐ 50-99	☐ 5,001-10,000	☐ 50,001-100,000
☐ 100-199	☐ 10,001-25,000	☒ More than 100,000
☐ 200-999		

15. Estimated assets
consolidated

☐ $0-$50,000	☐ $1,000,001-$10 million	☐ $500,000,001-$1 billion
☐ $50,001-$100,000	☐ $10,000,001-$50 million	☒ $1,000,000,001-$10 billion
☐ $100,001-$500,000	☐ $50,000,001-$100 million	☐ $10,000,000,001-$50 billion
☐ $500,001-$1 million	☐ $100,000,001-$500 million	☐ More than $50 billion

16. Estimated liabilities
consolidated

☐ $0-$50,000	☐ $1,000,001-$10 million	☐ $500,000,001-$1 billion
☐ $50,001-$100,000	☐ $10,000,001-$50 million	☒ $1,000,000,001-$10 billion
☐ $100,001-$500,000	☐ $50,000,001-$100 million	☐ $10,000,000,001-$50 billion
☐ $500,001-$1 million	☐ $100,000,001-$500 million	☐ More than $50 billion

Request for Relief, Declaration, and Signatures

WARNING -- Bankruptcy fraud is a serious crime. Making a false statement in connection with a bankruptcy case can result in fines up to $500,000 or imprisonment for up to 20 years, or both. 18 U.S.C. §§ 152, 1341, 1519, and 3571.

17. Declaration and signature of authorized representative of debtor

The debtor requests relief in accordance with the chapter of title 11, United States Code, specified in this petition.

I have been authorized to file this petition on behalf of the debtor.

I have examined the information in this petition and have a reasonable belief that the information is true and correct.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on 11 / 28 / 2022
MM / DD / YYYY

✘ _____
Signature of authorized representative of debtor

Zachary Prince
Printed name

Title Chief Executive Officer

Debtor BlockFi Inc. Case number (*if known*)
Name

18. Signature of attorney

✘ /s/ Michael D. Sirota /s/ Richard S. Kanowitz Date 11/28/2022
Signature of attorney for debtor MM / DD / YYYY

Michael D. Sirota Richard S. Kanowitz
Printed name

Cole Schotz P.C. Haynes and Boone, LLP
Firm name

25 Main Street 30 Rockefeller Plaza, 26th Floor, New York, NY 10112
Number Street

Hackensack NJ 07601
City State ZIP Code

(201) 489-3000 msirota@coleschotz.com
Contact phone

richard.kanowitz@haynesboone.com
Email address

014321986 (Sirota); 047911992 (Kanowitz) New Jersey
Bar number State

RIDER 1

Pending Bankruptcy Cases Filed by the Debtor and Affiliates of the Debtor

On the date hereof, each of the entities listed below (collectively, the "Debtors") filed a petition in the United States Bankruptcy Court for the District of New Jersey for relief under chapter 11 of title 11 of the United States Code. The Debtors have moved for joint administration of these cases under the case number assigned to the chapter 11 case of BlockFi Inc.

BlockFi Inc.

BlockFi Trading LLC

BlockFi Lending LLC

BlockFi Wallet LLC

BlockFi Ventures LLC

BlockFi International Ltd.

BlockFi Investment Products LLC

BlockFi Services, Inc.

BlockFi Lending II LLC

Fill in this information to identify the case and this filing:

Debtor Name BlockFi Inc.

United States Bankruptcy Court for the: _____ District of New Jersey (State)

Case number (*If known*): 22-_____

Official Form 202

Declaration Under Penalty of Perjury for Non-Individual Debtors

12/15

An individual who is authorized to act on behalf of a non-individual debtor, such as a corporation or partnership, must sign and submit this form for the schedules of assets and liabilities, any other document that requires a declaration that is not included in the document, and any amendments of those documents. This form must state the individual's position or relationship to the debtor, the identity of the document, and the date. Bankruptcy Rules 1008 and 9011.

WARNING -- Bankruptcy fraud is a serious crime. Making a false statement, concealing property, or obtaining money or property by fraud in connection with a bankruptcy case can result in fines up to $500,000 or imprisonment for up to 20 years, or both. 18 U.S.C. §§ 152, 1341, 1519, and 3571.

Declaration and signature

I am the president, another officer, or an authorized agent of the corporation; a member or an authorized agent of the partnership; or another individual serving as a representative of the debtor in this case.

I have examined the information in the documents checked below and I have a reasonable belief that the information is true and correct:

- ☐ *Schedule A/B: Assets–Real and Personal Property* (Official Form 206A/B)
- ☐ *Schedule D: Creditors Who Have Claims Secured by Property* (Official Form 206D)
- ☐ *Schedule E/F: Creditors Who Have Unsecured Claims* (Official Form 206E/F)
- ☐ *Schedule G: Executory Contracts and Unexpired Leases* (Official Form 206G)
- ☐ *Schedule H: Codebtors* (Official Form 206H)
- ☐ *Summary of Assets and Liabilities for Non-Individuals* (Official Form 206Sum)
- ☐ Amended *Schedule* ____
- ☒ *Chapter 11 or Chapter 9 Cases: List of Creditors Who Have the 20 Largest Unsecured Claims and Are Not Insiders* (Official Form 204)
- ☒ Other document that requires a declaration List of Equity Security Holders and Statement of Corporate Ownership

I declare under penalty of perjury that the foregoing is true and correct.

Executed on 11/28/2022
MM / DD / YYYY

✘ _____
Signature of individual signing on behalf of debtor

Zachary Prince
Printed name

Chief Executive Officer
Position or relationship to debtor

Fill in this information to identify the case:

Debtor name: BlockFi Inc., *et al.*

United States Bankruptcy Court for the: District of New Jersey

Case number (if known): _____

☐ Check if this is an amended filing

Official Form 204

Chapter 11 or Chapter 9: List of Creditors Who Have the 50 Largest Unsecured Claims and Are Not Insiders

12/15

A list of creditors holding the 50 largest unsecured claims must be filed in a Chapter 11 or Chapter 9 case. Include claims which the debtor disputes. Do not include claims by any person or entity who is an insider, as defined in 11 U.S.C. § 101(31). Also, do not include claims by secured creditors, unless the unsecured claim resulting from inadequate collateral value places the creditor among the holders of the 50 largest unsecured claims.

	Name of creditor and complete mailing address, including zip code	Name, telephone number, and email address of creditor contact	Nature of the claim (for example, trade debts, bank loans, professional services, and government contracts)	Indicate if claim is contingent, unliquidated, or disputed [1]	Amount of unsecured claim If the claim is fully unsecured, fill in only unsecured claim amount. If claim is partially secured, fill in total claim amount and deduction for value of collateral or setoff to calculate unsecured claim.		
					Total claim, if partially secured	Deduction for value of collateral or setoff	Unsecured Claim
1	Ankura Trust Company, LLC, as Trustee for the Indenture dated as of February 28, 2022 James J. McGinley 140 Sherman Street, 4th Floor Fairfield, CT 06824	Ankura Trust Company, LLC, as Trustee for the Indenture dated as of February 28, 2022 James J. McGinley PHONE: 203-319-6900 EMAIL: james.mcginley@ankura.com	Indenture				$729,036,246.00
2	West Realm Shires Inc. (FTX US) John J. Ray III 3500 South Dupont Highway Dover, DE 19901	West Realm Shires Inc. (FTX US) John J. Ray III	Loan				$275,000,000.00
3	Name and Address on File	Information on File	Client				$48,561,400.00
4	Securities & Exchange Commission Hane Kim Brookfield Place 200 Vesey Street, Suite 400 New York, NY 10281-1022	Securities & Exchange Commission Hane Kim PHONE: 212-336-1088 EMAIL: kimha@SEC.GOV	Settlement				$30,000,000.00
5	Name and Address on File	Information on File	Client				$27,930,663.00
6	Name and Address on File	Information on File	Client				$25,531,937.00
7	Name and Address on File	Information on File	Client				$16,450,930.00
8	Name and Address on File	Information on File	Client				$10,092,477.00
9	Name and Address on File	Information on File	Client				$9,130,266.00
10	Name and Address on File	Information on File	Client				$6,500,000.00

[1] As of the Petition Date, an analysis of whether the foregoing claims are contingent, unliquidated or disputed has not been completed

Debtor: BlockFi Inc., *et al.* Case number (if known) _____

	Name of creditor and complete mailing address, including zip code	Name, telephone number, and email address of creditor contact	Nature of the claim (for example, trade debts, bank loans, professional services, and government contracts)	Indicate if claim is contingent, unliquidated, or disputed [1]	Amount of unsecured claim If the claim is fully unsecured, fill in only unsecured claim amount. If claim is partially secured, fill in total claim amount and deduction for value of collateral or setoff to calculate unsecured claim.		
					Total claim, if partially secured	Deduction for value of collateral or setoff	Unsecured Claim
11	Name and Address on File	Information on File	Client				$6,416,732.00
12	Name and Address on File	Information on File	Client				$6,264,675.00
13	Name and Address on File	Information on File	Client				$6,042,827.00
14	Name and Address on File	Information on File	Client				$5,713,322.00
15	Name and Address on File	Information on File	Client				$5,500,232.00
16	Name and Address on File	Information on File	Client				$5,482,181.00
17	Name and Address on File	Information on File	Client				$5,000,000.00
18	Name and Address on File	Information on File	Client				$4,670,469.00
19	Name and Address on File	Information on File	Client				$3,995,213.00
20	Name and Address on File	Information on File	Client				$3,290,438.00
21	Name and Address on File	Information on File	Client				$3,290,186.00
22	Name and Address on File	Information on File	Client				$3,092,832.00
23	Name and Address on File	Information on File	Client				$3,084,390.00

Debtor: BlockFi Inc., *et al.* Case number (if known) _____

	Name of creditor and complete mailing address, including zip code	Name, telephone number, and email address of creditor contact	Nature of the claim (for example, trade debts, bank loans, professional services, and government contracts)	Indicate if claim is contingent, unliquidated, or disputed [1]	Amount of unsecured claim If the claim is fully unsecured, fill in only unsecured claim amount. If claim is partially secured, fill in total claim amount and deduction for value of collateral or setoff to calculate unsecured claim.		
					Total claim, if partially secured	Deduction for value of collateral or setoff	Unsecured Claim
24	Name and Address on File	Information on File	Client				$2,733,625.00
25	Name and Address on File	Information on File	Client				$2,618,909.00
26	Name and Address on File	Information on File	Client				$2,600,000.00
27	Name and Address on File	Information on File	Client				$2,527,023.00
28	Name and Address on File	Information on File	Client				$2,385,343.00
29	Name and Address on File	Information on File	Institutional Loans		$21,670,000.00	$19,405,815.00	$2,264,185.00
30	Name and Address on File	Information on File	Client				$2,195,060.00
31	Name and Address on File	Information on File	Client				$2,028,277.00
32	Name and Address on File	Information on File	Client				$1,799,293.00
33	Name and Address on File	Information on File	Client				$1,769,481.00
34	Name and Address on File	Information on File	Client				$1,693,730.00
35	Name and Address on File	Information on File	Client				$1,680,488.00
36	Name and Address on File	Information on File	Client				$1,647,320.00

Debtor: BlockFi Inc., *et al.* Case number (if known) _____

	Name of creditor and complete mailing address, including zip code	Name, telephone number, and email address of creditor contact	Nature of the claim (for example, trade debts, bank loans, professional services, and government contracts)	Indicate if claim is contingent, unliquidated, or disputed [1]	Amount of unsecured claim If the claim is fully unsecured, fill in only unsecured claim amount. If claim is partially secured, fill in total claim amount and deduction for value of collateral or setoff to calculate unsecured claim.		
					Total claim, if partially secured	Deduction for value of collateral or setoff	Unsecured Claim
37	Name and Address on File	Information on File	Client				$1,646,355.00
38	Name and Address on File	Information on File	Client				$1,630,590.00
39	Name and Address on File	Information on File	Client				$1,535,700.00
40	Name and Address on File	Information on File	Client				$1,471,911.00
41	Name and Address on File	Information on File	Client				$1,454,081.00
42	Name and Address on File	Information on File	Client				$1,398,077.00
43	Name and Address on File	Information on File	Client				$1,354,519.00
44	Name and Address on File	Information on File	Client				$1,253,815.00
45	Name and Address on File	Information on File	Client				$1,201,448.00
46	Name and Address on File	Information on File	Client				$1,100,609.00
47	Name and Address on File	Information on File	Client				$1,046,888.00
48	Name and Address on File	Information on File	Client				$1,042,364.00
49	Name and Address on File	Information on File	Client				$1,000,189.00

Debtor: BlockFi Inc., *et al.* Case number (if known) _____

	Name of creditor and complete mailing address, including zip code	Name, telephone number, and email address of creditor contact	Nature of the claim (for example, trade debts, bank loans, professional services, and government contracts)	Indicate if claim is contingent, unliquidated, or disputed [1]	Amount of unsecured claim If the claim is fully unsecured, fill in only unsecured claim amount. If claim is partially secured, fill in total claim amount and deduction for value of collateral or setoff to calculate unsecured claim.		
					Total claim, if partially secured	Deduction for value of collateral or setoff	Unsecured Claim
50	Name and Address on File	Information on File	Client				$999,650.00

B2030 (Form 2030) (12/15)

United States Bankruptcy Court

_____ District Of New Jersey

In re

BlockFi Inc.

Case No. 22-_____

Debtor

Chapter 11

DISCLOSURE OF COMPENSATION OF ATTORNEY FOR DEBTOR

1. Pursuant to 11 U .S.C. § 329(a) and Fed. Bankr. P. 2016(b), I certify that I am the attorney for the above named debtor(s) and that compensation paid to me within one year before the filing of the petition in bankruptcy, or agreed to be paid to me, for services rendered or to be rendered on behalf of the debtor(s) in contemplation of or in connection with the bankruptcy case is as follows:

   For legal services, I have agreed to accept . . . . . $ 100,000 (retainer)

   Prior to the filing of this statement I have received . . . . . $ 85,852.50*

   Balance Due . . . . . $ 0.00

2. The source of the compensation paid to me was:

   ☒ Debtor ☐ Other (specify)

3. The source of compensation to be paid to me is:

   ☒ Debtor ☐ Other (specify)

* In addition to the above-referenced $85,852.50 in compensation for services rendered prior to the Petition Date, Cole Schotz has received $1,738 in chapter 11 filing fees for this debtor, and $1,738 in chapter 11 filing fees for each of this debtor's affiliated debtors and debtors in possession.

4. ☒ I have not agreed to share the above-disclosed compensation with any other person unless they are members and associates of my law firm.

   ☐ I have agreed to share the above-disclosed compensation with a other person or persons who are not members or associates of my law firm. A copy of the agreement, together with a list of the names of the people sharing in the compensation, is attached.

5. In return for the above-disclosed fee, I have agreed to render legal service for all aspects of the bankruptcy case, including:

   a. Analysis of the debtor' s financial situation, and rendering advice to the debtor in determining whether to file a petition in bankruptcy;

   b. Preparation and filing of any petition, schedules, statements of affairs and plan which may be required;

   c. Representation of the debtor at the meeting of creditors and confirmation hearing, and any adjourned hearings thereof;

B2030 (Form 2030) (12/15)

d. Representation of the debtor in adversary proceedings and other contested bankruptcy matters;

e. [Other provisions as needed]

See retention papers.

6. By agreement with the debtor(s), the above-disclosed fee does not include the following services:

None.

CERTIFICATION

I certify that the foregoing is a complete statement of any agreement or arrangement for payment to me for representation of the debtor(s) in this bankruptcy proceeding.

11/28/2022
Date

/s/ Michael D. Sirota
Signature of Attorney

Cole Schotz P.C.
Name of law firm

B2030 (Form 2030) (12/15)

United States Bankruptcy Court

_____ District Of New Jersey

In re

Case No. 22-_____

Debtor BlockFi Inc. Chapter 11_____

DISCLOSURE OF COMPENSATION OF ATTORNEY FOR DEBTOR

1. Pursuant to 11 U .S.C. § 329(a) and Fed. Bankr. P. 2016(b), I certify that I am the attorney for the above named debtor(s) and that compensation paid to me within one year before the filing of the petition in bankruptcy, or agreed to be paid to me, for services rendered or to be rendered on behalf of the debtor(s) in contemplation of or in connection with the bankruptcy case is as follows:

   For legal services, I have agreed to accept . . . . . $ 750,000 (retainer)

   Prior to the filing of this statement I have received . . . . . $ 1,904,529.03

   Balance Due . . . . . $ 0

2. The source of the compensation paid to me was:

   ☒ Debtor ☐ Other (specify)

3. The source of compensation to be paid to me is:

   ☒ Debtor ☐ Other (specify)

4. ☒ I have not agreed to share the above-disclosed compensation with any other person unless they are members and associates of my law firm.

   ☐ I have agreed to share the above-disclosed compensation with a other person or persons who are not members or associates of my law firm. A copy of the agreement, together with a list of the names of the people sharing in the compensation, is attached.

5. In return for the above-disclosed fee, I have agreed to render legal service for all aspects of the bankruptcy case, including:

   a. Analysis of the debtor' s financial situation, and rendering advice to the debtor in determining whether to file a petition in bankruptcy;

   b. Preparation and filing of any petition, schedules, statements of affairs and plan which may be required;

   c. Representation of the debtor at the meeting of creditors and confirmation hearing, and any adjourned hearings thereof;

B2030 (Form 2030) (12/15)

d. Representation of the debtor in adversary proceedings and other contested bankruptcy matters;

e. [Other provisions as needed]

see retention papers

6. By agreement with the debtor(s), the above-disclosed fee does not include the following services:

none.

CERTIFICATION

I certify that the foregoing is a complete statement of any agreement or arrangement for payment to me for representation of the debtor(s) in this bankruptcy proceeding.

11/28/2022
Date

Richard Kanowitz
Signature of Attorney

Haynes and Boone, LLP
Name of law firm

B2030 (Form 2030) (12/15)

United States Bankruptcy Court

_____ District Of New Jersey

In re BlockFi Inc.

Case No. 22 - _____

Debtor

Chapter 11

DISCLOSURE OF COMPENSATION OF ATTORNEY FOR DEBTOR

1. Pursuant to 11 U .S.C. § 329(a) and Fed. Bankr. P. 2016(b), I certify that I am the attorney for the above named debtor(s) and that compensation paid to me within one year before the filing of the petition in bankruptcy, or agreed to be paid to me, for services rendered or to be rendered on behalf of the debtor(s) in contemplation of or in connection with the bankruptcy case is as follows:

   For legal services, I have agreed to accept . . . . . $ 2,000,000.00 (retainer)

   Prior to the filing of this statement I have received . . . . . $ 1,470,327.45

   Balance Due . . . . . $ 0.00

2. The source of the compensation paid to me was:

   ☒ Debtor ☐ Other (specify)

3. The source of compensation to be paid to me is:

   ☒ Debtor ☐ Other (specify)

4. ☒ I have not agreed to share the above-disclosed compensation with any other person unless they are members and associates of my law firm.

   ☐ I have agreed to share the above-disclosed compensation with a other person or persons who are not members or associates of my law firm. A copy of the agreement, together with a list of the names of the people sharing in the compensation, is attached.

5. In return for the above-disclosed fee, I have agreed to render legal service for all aspects of the bankruptcy case, including:

   a. Analysis of the debtor' s financial situation, and rendering advice to the debtor in determining whether to file a petition in bankruptcy;

   b. Preparation and filing of any petition, schedules, statements of affairs and plan which may be required;

   c. Representation of the debtor at the meeting of creditors and confirmation hearing, and any adjourned hearings thereof;

B2030 (Form 2030) (12/15)

d. Representation of the debtor in adversary proceedings and other contested bankruptcy matters;

e. [Other provisions as needed]

See retention papers.

6. By agreement with the debtor(s), the above-disclosed fee does not include the following services:

CERTIFICATION

I certify that the foregoing is a complete statement of any agreement or arrangement for payment to me for representation of the debtor(s) in this bankruptcy proceeding.

November 28, 2022
Date

/s/ *Christine A. Okike*
Signature of Attorney

Kirkland & Ellis LLP and Kirkland & Ellis International LLP
Name of law firm

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In re: BlockFi Inc. Debtor.	Chapter 11 Case No. 22-_____ (___) (Joint Administration Requested)

LIST OF EQUITY SECURITY HOLDERS

Pursuant to Rule 1007(a)(3) of the Federal Rules of Bankruptcy Procedure, BlockFi International Ltd. hereby provides the following list of holders of equity interests:

Name and Address of Interest Holder	Kind of Interest	Percentage of Interests Held
Intentionally omitted for purposes of filing.		

DATED: November 28, 2022

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In re: BlockFi Inc. Debtors.	Chapter 11 Case No. 22-_____ (___) (Joint Administration Requested)

STATEMENT OF CORPORATE OWNERSHIP

Pursuant to Rules 1007(a)(1) and 7007.1 of the Federal Rules of Bankruptcy Procedure, the undersigned authorized officer of BlockFi Inc. certifies that the following corporate entities/individuals own more than 10% of the Debtor's equity interest.

Shareholder	Percentage of Total Shares
Valar Fund V LP	19%

DATED: November 28, 2022

ACTION BY JOINT UNANIMOUS
WRITTEN CONSENT OF THE GOVERNING BODIES

November 27, 2022

The undersigned, being (i) all the members of the board of directors, (ii) all the managers, or (iii) all the members, whether one or more, as the case may be (each, a "**Governing Body**" and, collectively, the "**Governing Bodies**"), of the entities specified on the signature pages hereto (collectively, the "**Company**") do hereby consent to, adopt, and approve the resolutions set forth herein by joint written consent (this "**Consent**"), pursuant to (as applicable) and in accordance with the articles of incorporation, limited liability company agreement, operating agreement, bylaws, or similar governing document (in each case as amended or amended and restated) of each Company and the laws of the state, province, or country of formation of each Company as set forth next to each Company's name on **Exhibit A**.

WHEREAS, the Governing Bodies have reviewed and considered presentations by the management and the financial and legal advisors of the Company regarding the liabilities and liquidity situation of the Company, the strategic alternatives available to it, and the effect of the foregoing on the Company's business.

WHEREAS, the Governing Bodies have had the opportunity to consult with the management and the financial and legal advisors of the Company and to fully consider each of the strategic alternatives available to the Company.

WHEREAS, the Governing Bodies have reviewed and considered presentations by the management and the financial and legal advisors of the Company regarding the transactions contemplated under the proposed chapter 11 plan of reorganization (the "**Plan**").

WHEREAS, the Company engaged Willis Towers Watson ("**WTW**") to assist the Companies in analyzing the compensation arrangements of their respective employees;

WHEREAS, with the assistance of WTW, the Company has developed (i) the non-insider key employee retention program in the form received and reviewed by the undersigned (as the same may be modified with the approval of the undersigned, the "**KERP**") for certain of their employees and (ii) the non-insider targeted retention plan in the form received and reviewed by the undersigned (as the same may be modified with the approval of the undersigned, the "**TRP**") for certain of their employees;

WHEREAS, WTW has vetted and performed a *de novo* review of the KERP and the TRP in an effort to determine whether the KERP and the TRP are consistent with market practices and compensation levels for other companies operating in chapter 11, and, following its review, WTW prepared a report with respect to the KERP and the TRP (the "**WTW Presentation**"); and

WHEREAS, the Governing Bodies have consulted with management, WTW, and the Company's restructuring counsel and other advisors regarding the KERP and the TRP; and

WHEREAS, after its review of the WTW Presentation and further deliberation and discussion with the Company's advisors and the Company's management team, the Governing Bodies deem it advisable and in the best interests of the Company, its creditors, and parties in interest to authorize the Company to implement and adopt the KERP and the TRP to retain certain non-insider employees for the duration of the Company's Chapter 11 Cases and for the Company to take any actions (including seeking approval of the KERP and the TRP from the United States Bankruptcy Court for the District of New Jersey (the "**Bankruptcy Court**")) to implement the KERP and the TRP.

NOW, THEREFORE, BE IT

Chapter 11 Filing

RESOLVED, that, in the judgment of each applicable Governing Body, it is desirable and in the best interests of the Company, its stakeholders, its creditors, and other parties in interest, that each Company shall be, and hereby is, authorized to file, or cause to be filed, a voluntary petition for relief (each, a "**Chapter 11 Case**") under the provisions of chapter 11 of title 11 of the United States Code (the "**Bankruptcy Code**") in the Bankruptcy Court and any other petition for relief or recognition or other order that may be desirable under applicable law in the United States.

RESOLVED, that any of the Chief Executive Officer, President, Chief Financial Officer, any Executive Vice President, General Counsel, and Secretary or any other duly appointed officer of each Company (collectively, the "Authorized Signatories"), acting alone or with one or more other Authorized Signatories be, and they hereby are, authorized, empowered, and directed to execute and file on behalf of each Company all petitions, schedules, lists, and other motions, papers, or documents, and to take any and all other action that they deem necessary or proper to obtain such relief, including, without limitation, any action necessary to maintain the ordinary course operation of each Company's business.

Retention of Professionals

RESOLVED, that each of the Authorized Signatories be, and hereby is, authorized and directed to employ the law firm of Kirkland & Ellis LLP and Kirkland & Ellis International LLP (together, "**Kirkland**") as general bankruptcy co-counsel to represent and assist the Company in carrying out its duties under the Bankruptcy Code, and to take any and all actions to advance the Company's rights and obligations, including filing any motions, objections, replies, applications, or pleadings; and in connection therewith, each of the Authorized Signatories, with power of delegation, is hereby authorized and directed to execute appropriate retention agreements, pay appropriate retainers, and to cause to be filed an appropriate application for authority to retain the services of Kirkland.

RESOLVED, that each of the Authorized Signatories be, and hereby is, authorized and directed to employ the law firm of Haynes and Boone, LLP ("**Haynes Boone**") as general bankruptcy co-counsel to represent and assist the Company in carrying out its duties under the Bankruptcy Code, and to take any and all actions to advance the Company's rights and obligations, including filing any motions, objections, replies, applications, or pleadings; and in connection therewith, each of the Authorized Signatories, with power of delegation, is hereby authorized and directed to execute appropriate retention agreements, pay appropriate retainers, and to cause to be filed an appropriate application for authority to retain the services of Haynes Boone.

RESOLVED, that each of the Authorized Signatories be, and hereby is, authorized and directed to employ the law firm of Cole Schotz P.C. ("**Cole Schotz**") as local bankruptcy counsel to represent and assist the Company in carrying out its duties under the Bankruptcy Code, and to take any and all actions to advance the Company's rights and obligations, including filing any motions, objections, replies, applications, or pleadings; and in connection therewith, each of the Authorized Signatories, with power of delegation, is hereby authorized and directed to execute appropriate retention agreements, pay appropriate retainers, and to cause to be filed an appropriate application for authority to retain the services of Cole Schotz.

RESOLVED, that each of the Authorized Signatories be, and hereby is, authorized and directed to employ the firm of Berkeley Research Group, LLC ("**BRG**"), as financial advisor to represent and assist the Company in carrying out its duties under the Bankruptcy Code, and to take any and all actions to

advance the Company's rights and obligations; and in connection therewith, each of the Authorized Signatories, with power of delegation, is hereby authorized and directed to execute appropriate retention agreements, pay appropriate retainers, and to cause to be filed an appropriate application for authority to retain the services of BRG.

RESOLVED, that each of the Authorized Signatories be, and hereby is, authorized and directed to employ the firm of Moelis & Company ("**Moelis**"), as investment banker to represent and assist the Company in carrying out its duties under the Bankruptcy Code, and to take any and all actions to advance the Company's rights and obligations; and in connection therewith, each of the Authorized Signatories, with power of delegation, is hereby authorized and directed to execute appropriate retention agreements, pay appropriate retainers, and to cause to be filed an appropriate application for authority to retain the services of Moelis.

RESOLVED, that each of the Authorized Signatories be, and hereby is, authorized and directed to employ the firm of C Street Advisory Group, LLC ("**C Street**"), as strategic and communications advisors to represent and assist the Company in carrying out its duties under the Bankruptcy Code, and to take any and all actions to advance the Company's rights and obligations; and in connection therewith, each of the Authorized Signatories, with power of delegation, is hereby authorized and directed to execute appropriate retention agreements, pay appropriate retainers, and to cause to be filed an appropriate application for authority to retain the services of C Street.

RESOLVED, that each of the Authorized Signatories be, and hereby is, authorized and directed to employ the firm of Walkers (Bermuda) Limited ("**Walkers**") as special Bermuda counsel to represent and assist the Company in carrying out its duties under the Bankruptcy Code, and to take any and all actions to advance the Company's rights and obligations; and in connection therewith, each of the Authorized Signatories, with power of delegation, is hereby authorized and directed to execute appropriate retention agreements, pay appropriate retainers, and to cause to be filed appropriate applications for authority to retain the services of Walkers.

RESOLVED, that each of the Authorized Signatories be, and hereby is, authorized and directed to employ the firm of Kroll Restructuring Administration LLC ("**Kroll**") as notice and claims agent to represent and assist the Company in carrying out its duties under the Bankruptcy Code, and to take any and all actions to advance the Company's rights and obligations; and in connection therewith, each of the Authorized Signatories, with power of delegation, is hereby authorized and directed to execute appropriate retention agreements, pay appropriate retainers, and to cause to be filed appropriate applications for authority to retain the services of Kroll.

RESOLVED, that each of the Authorized Signatories be, and hereby is, authorized and directed to employ any other professionals to assist the Company in carrying out its duties under the Bankruptcy Code; and in connection therewith, each of the Authorized Signatories, with power of delegation, is hereby authorized and directed to execute appropriate retention agreements, pay appropriate retainers and fees, and to cause to be filed an appropriate application for authority to retain the services of any other professionals as necessary.

RESOLVED, that each of the Authorized Signatories be, and hereby is, with power of delegation, authorized, empowered, and directed to execute and file all petitions, schedules, motions, lists, applications, pleadings, and other papers and, in connection therewith, to employ and retain all assistance by legal counsel, accountants, financial advisors, and other professionals and to take and perform any and all further

acts and deeds that each of the Authorized Signatories deem necessary, proper, or desirable in connection with the Company's Chapter 11 Case, with a view to the successful prosecution of such case.

Bermuda Ancillary Proceedings

RESOLVED, that in the judgment of the Governing Body of BlockFi International Ltd. ("**BlockFi International**") it is desirable and in the best interest of BlockFi International, its interest holders, its creditors, and other parties in interest, that BlockFi International file or cause to be filed a winding-up petition in furtherance of a local Bermuda proceedings (the "**Bermuda Petition**") in the Supreme Court of Bermuda (the "**Bermuda Court**");

RESOLVED, that each of the Authorized Signatories be, and hereby is, authorized to file or cause to be filed with the Bermuda Court the Bermuda Petition;

RESOLVED, that each of the Authorized Signatories be, and hereby is, authorized, empowered and directed to, concurrent with the filing of the Bermuda Petition, make an application to appoint [Ernst & Young] as joint provisional liquidator; and

RESOLVED, that each of the Authorized Signatories be, and hereby is, authorized and empowered to execute (under the Common Seal of the Company, if appropriate), deliver, and file or cause to be filed with the Bermuda Court, including through Walkers, on behalf of BlockFi International, all papers, motions, applications, schedules, and pleadings necessary or convenient to facilitate the Bermuda Petition and all other matters and proceedings, and any and all other documents, including affidavits and declarations, necessary or appropriate in connection with the Bermuda Petition, each in such form or forms as the Authorized Signatories may approve, such approval to be conclusively evidenced by said individual taking such action or the execution thereof.

Non-Insider Key Employee Retention Program

RESOLVED, that the Company approves and adopts the KERP and the TRP (in each case, as the same may be subject to approval from the Bankruptcy Court); and

RESOLVED, that any of Authorized Signatories be, and each hereby is, authorized, empowered, and directed to cause the Company to implement the KERP and the TRP;

General

RESOLVED, that with respect to each of the foregoing entities authorized to file a chapter 11 case (each a "**Filing Entity**" and, collectively, the "**Filing Entities**"), any and all past actions heretofore taken by the Authorized Signatories, any director, any manager, or any member of any Filing Entity in the name and on behalf of such Filing Entity in furtherance of any or all of the preceding resolutions be, and the same hereby are, ratified, confirmed, and approved in all respects; and be it further

RESOLVED, that the Governing Body of each Filing Entity has received sufficient notice of the actions and transactions relating to the matters contemplated by this Consent, as required by the governance documents of such Filing Entity, or hereby waives any right to have received such notice.

* * * *

Exhibit A

Company

Company	Jurisdiction
BlockFi Inc.	Delaware
BlockFi Wallet LLC	Delaware
BlockFi Ventures LLC	Delaware
BlockFi Trading LLC	Delaware
BlockFi Services, Inc.	Delaware
BlockFi Lending LLC	Delaware
BlockFi Lending II LLC	Delaware
BlockFi Investment Products LLC	Delaware
BlockFi International Ltd.	Bermuda

IN WITNESS WHEREOF, the undersigned have executed and delivered this consent effective as of the date first set forth above.

BLOCKFI INC.

DocuSigned by:
ZACHARY LEE PRINCE
FFA30A9A87CD4EC...
Name: Zachary Lee Prince
Title: Director

DocuSigned by:
Florencia Marquez
CAC0F2EFBD6E4EF...
Name: Florencia Marquez
Title: Director

DocuSigned by:
Tony Lauro
28142D29929E438...
Name: Tony Lauro II
Title: Director

DocuSigned by:
AE687164E6F7473...
Name: Jennifer Hill
Title: Independent Director

DocuSigned by:
Scott Vogel
7F05CED1CE7140C...
Name: Scott Vogel
Title: Independent Director

IN WITNESS WHEREOF, the undersigned have executed and delivered this consent effective as of the date first set forth above.

BLOCKFI TRADING LLC

DocuSigned by:
Alan Carr
0DBFF8FF8184420...

Name: Alan J. Carr
Title: Independent Manager

IN WITNESS WHEREOF, the undersigned have executed and delivered this consent effective as of the date first set forth above.

BLOCKFI LENDING LLC

DocuSigned by:
Harvey Tepner
23378E03C0EA4DA...

Name: Harvey L. Tepner
Title: Independent Manager

IN WITNESS WHEREOF, the undersigned have executed and delivered this consent effective as of the date first set forth above.

BLOCKFI LENDING II LLC

By: **BLOCKFI LENDING LLC**
Its: Sole Member

DocuSigned by:
ZACHARY LEE PRINCE
FFA30A9A87CD4EC...

Name: Zachary Lee Prince
Title: President

IN WITNESS WHEREOF, the undersigned have executed and delivered this consent effective as of the date first set forth above.

BLOCKFI WALLET LLC

DocuSigned by:
Pamela Corrie
F0897890FA8F41A...

Name: Pamela B. Corrie
Title: Independent Manager

IN WITNESS WHEREOF, the undersigned have executed and delivered this consent effective as of the date first set forth above.

BLOCKFI VENTURES LLC
BLOCKFI INVESTMENT PRODUCTS LLC

By: **BLOCKFI INC.**
Its: Sole Member

DocuSigned by:
ZACHARY LEE PRINCE
FFA30A9A87CD4EC...

Name: Zachary Lee Prince
Title: Chief Executive Officer and President

IN WITNESS WHEREOF, the undersigned have executed and delivered this consent effective as of the date first set forth above.

BLOCKFI SERVICES, INC.,

DocuSigned by:
Amit Cheela
5C0922B64A814DC...

Name: Amit Cheela
Title: Director

IN WITNESS WHEREOF, the undersigned have executed and delivered this consent effective as of the date first set forth above.

BLOCKFI INTERNATIONAL LTD.

DocuSigned by:
3C0FA39E80704C3...

Name: Jill Frizzley
Title: Director

TAB 20

In re Cred, Inc., Case No. 20-12836 (Bankr. D. Del.) Doc. No. 605

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 11
CRED INC., *et al.*,[1]	Case No. 20-12836 (JTD)
Debtors.	(Jointly Administered)

REPORT OF ROBERT J. STARK, EXAMINER

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ANKURA CONSULTING GROUP, LLC
Vikram Kapoor
485 Lexington Avenue, 10th Floor
New York, NY 10017
212-818-1555
vikram.kapoor@ankura.com

Dated: March 8, 2021

[1] The Debtors in these chapter 11 cases, along with the last four digits of each debtor's tax identification number are as follows: Cred Inc. (8268), Cred (US) LLC (5799), Cred Capital, Inc. (4064), Cred Merchant Solutions LLC (3150), and Cred (Puerto Rico) LLC (3566). The Debtors' mailing address is 3 East Third Avenue, Suite 200, San Mateo, California 94401.

TAB 21

In re Celsius Network LLC, Case No. 22-10964 (Bankr. S.D.N.Y.) Doc. No. 1956

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	Chapter 11
CELSIUS NETWORK LLC, *et al.*,	Case No. 22-10964 (MG)
Debtors.	(Jointly Administered)

FINAL REPORT OF SHOBA PILLAY, EXAMINER

Jenner & Block LLP
353 N. Clark Street
Chicago, Illinois 60654
(312) 222-9350

1155 Avenue of the Americas
New York, New York 10036
(212) 891-1600

Counsel to the Examiner

January 30, 2023

TAB 22

In re FTX Trading Ltd., Case No. 22-11068 (Bankr. D. Del.) Doc. No. 24

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 11
FTX TRADING LTD., *et al.*,[1]	Case No. 22-11068 (JTD)
Debtors.	(Joint Administration Pending)

DECLARATION OF JOHN J. RAY III IN SUPPORT OF CHAPTER 11 PETITIONS AND FIRST DAY PLEADINGS

I, John J. Ray III, hereby declare under penalty of perjury as follows:

1. I am the Chief Executive Officer of the above-captioned debtors and debtors-in-possession (collectively, the "Debtors"), having accepted this position in the early morning hours of November 11, 2022. I am administering the interests and affairs of the Debtors from my offices in the United States.

2. My first official act in these roles was to authorize the chapter 11 filings of the Debtors and the commencement of the above-captioned chapter 11 cases (the "Chapter 11 Cases").

3. Since my appointment, I have worked around the clock with teams of professionals at Alvarez & Marsal, Sullivan & Cromwell, Nardello & Co., Chainalysis, Kroll and a confidential cybersecurity firm, to secure the assets of the Debtors wherever located, to identify reliable books and records, to assemble the information necessary to provide to this Court, and to respond to numerous inquiries from multiple regulators and government authorities including the

[1] The last four digits of FTX Trading Ltd.'s tax identification number are 3288. Due to the large number of debtor entities in these Chapter 11 Cases, a complete list of the Debtors and the last four digits of their federal tax identification numbers is not provided herein. A complete list of such information may be obtained on the website of the Debtors' proposed claims and noticing agent at https://cases.ra.kroll.com/FTX.

U.S. Commodity Futures Trading Commission ("CFTC"), the U.S. Attorney's Office for the Southern District of New York, the U.S. Securities and Exchange Commission ("SEC"), and the U.S. Congress, among others.

4. I have over 40 years of legal and restructuring experience. I have been the Chief Restructuring Officer or Chief Executive Officer in several of the largest corporate failures in history. I have supervised situations involving allegations of criminal activity and malfeasance (Enron). I have supervised situations involving novel financial structures (Enron and Residential Capital) and cross-border asset recovery and maximization (Nortel and Overseas Shipholding). Nearly every situation in which I have been involved has been characterized by defects of some sort in internal controls, regulatory compliance, human resources and systems integrity.

5. Never in my career have I seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here. From compromised systems integrity and faulty regulatory oversight abroad, to the concentration of control in the hands of a very small group of inexperienced, unsophisticated and potentially compromised individuals, this situation is unprecedented.

6. These Chapter 11 Cases have five core objectives:

(a) **Implementation of Controls:** the implementation of accounting, audit, cash management, cybersecurity, human resources, risk management, data protection and other systems that did not exist, or did not exist to an appropriate degree, prior to my appointment;

(b) **Asset Protection & Recovery:** the location and security of property of the estate, a substantial portion of which may be missing or stolen;

(c) **Transparency and Investigation:** the pending, comprehensive, transparent and deliberate investigation into claims against Mr. Samuel Bankman-Fried, the other co-founders of the Debtors and third parties, in

coordination with regulatory stakeholders in the United States and around the world;

(d) **Efficiency and Coordination:** cooperation and coordination with insolvency proceedings of subsidiary companies in other jurisdictions; and

(e) **Maximization of Value:** the maximization of value for all stakeholders through the eventual reorganization or sale of the Debtors' complex array of businesses, investments and digital and physical property.

These proceedings in the District of Delaware are the appropriate means to accomplish each of these objectives.

7. Except as otherwise indicated herein, all facts set forth in this declaration (the "Declaration") are based on my personal knowledge, my review of relevant materials in the Debtors' files or my opinion based on my experience, knowledge and information concerning the Debtors' operations and financial affairs. I am over the age of 18 and authorized to submit this Declaration on behalf of each of the Debtors.

8. For the reasons explained below, the Debtors expect to provide supplemental declarations as to the subject matter of this Declaration in connection with future motions as more information becomes available to the Debtors, stakeholders and the Court.

I. THE PREPETITION DEBTORS

A. Corporate Organization and Identification of Four Silos

9. For purposes of managing the Debtors' affairs, I have identified four groups of businesses, which I refer to as "Silos." These Silos include: (a) a group composed of Debtor West Realm Shires Inc. and its Debtor and non-Debtor subsidiaries (the "WRS Silo"), which includes the businesses known as "FTX US," "LedgerX," "FTX US Derivatives," "FTX US Capital Markets," and "Embed Clearing," among other businesses; (b) a group composed of Debtor Alameda Research LLC and its Debtor subsidiaries (the "Alameda Silo"); (c) a group composed of Debtor Clifton Bay Investments LLC, Debtor Clifton Bay Investments Ltd., Debtor

Island Bay Ventures Inc. and Debtor FTX Ventures Ltd. (the "Ventures Silo"); and (d) a group composed of Debtor FTX Trading Ltd. and its Debtor and non-Debtor subsidiaries (the "Dotcom Silo"), including the exchanges doing business as "FTX.com" and similar exchanges in non-U.S. jurisdictions. These Silos together are referred to by me as the "FTX Group."

10. Each of the Silos was controlled by Mr. Bankman-Fried.[2] Minority equity interests in the Silos were held by Zixiao "Gary" Wang and Nishad Singh, the co-founders of the business along with Mr. Bankman-Fried. The WRS Silo and Dotcom Silo also have third party equity investors, including investment funds, endowments, sovereign wealth funds and families. To my knowledge, no single investor other than the co-founders owns more than 2% of the equity of any Silo.[3]

11. The diagram attached as Exhibit A provides a visual summary of the Silos and the indicative assets in each Silo. Exhibit B contains a preliminary corporate structure chart. These materials were prepared at my direction based on information available at this time and are subject to revision as our investigation into the affairs of the FTX Group continues.

B. The WRS Silo

12. The WRS Silo includes FTX US, an exchange for spot trading in digital assets and tokens. FTX US was founded in January 2020. FTX US is available to U.S. users

[2] To my knowledge, Mr. Bankman-Fried owns (a) directly, approximately 53% of the equity in Debtor West Realm Shires Inc.; (b) indirectly, approximately 75% of the equity in Debtor FTX Trading Ltd.; (c) directly, approximately 90% of the equity in Debtor Alameda Research LLC; and (d) directly, approximately 67% of the equity in Clifton Bay Investments LLC.

[3] Based on the information provided to me, the only Debtors that have received third party equity investments are Debtor FTX Trading Ltd. (Dotcom Silo) and Debtor West Realm Shires Inc. (WRS Silo). To my knowledge, (a) approximately 25% of the equity in Debtor FTX Trading Ltd. is owned by a dispersed group of approximately 600 third party equity investors and (b) approximately 22.25% of the equity in Debtor West Realm Shires Inc. is owned by a dispersed group of approximately 570 third party equity investors. FTX Trading Ltd also acquired 51% of Blockfolio, Inc. in 2020, with the remaining 49% of Blockfolio, Inc. owned by the original shareholders.

and, according to statements by Mr. Bankman-Fried, had approximately one million users as of August 2022. FTX US's spot exchange is registered with the Department of the Treasury (via the Financial Crimes Enforcement Network) as a money services business and holds a series of state money transmission licenses in the United States.

13. The WRS Silo also owns 100% of the equity interests in the LedgerX business, which is operated by non-Debtor LedgerX LLC (d/b/a FTX US Derivatives) ("LedgerX"). LedgerX offers futures, options, and swaps contracts on digital assets and other commodities to both U.S. and non-U.S. persons. LedgerX operates with licenses from the CFTC. Based on the information that I have reviewed at this time, LedgerX is solvent.

14. The WRS Silo also owns 100% of the equity interests in non-Debtor FTX Capital Markets LLC, which is an SEC-registered broker-dealer. Based on the information that I have reviewed at this time, FTX Capital Markets LLC is solvent.

15. The WRS Silo also owns 100% of the equity interests in non-Debtor Embed Financial Technologies Inc., as well as its wholly-owned non-Debtor subsidiary Embed Clearing LLC, which operates as a securities clearing firm and is an SEC-registered broker-dealer. Based on the information that I have reviewed at this time, each of these non-Debtor entities is solvent.

16. The WRS Silo also owns 100% of the equity interests in FTX Value Trust Company, a South Dakota Trust Company, which provides custodial services. Based on the information that I have reviewed at this time, this non-Debtor company is solvent.

17. The WRS Silo also owns 100% of other Debtor and non-Debtor companies operating miscellaneous businesses, such as video game development and a market place for trading non-fungible tokens. Finally, the WRS Silo has made loans and investments,

including a loan of FTT tokens to BlockFi Inc. in a principal amount of FTT tokens valued at $250 million as of September 30, 2022.

18. I have been provided with an unaudited consolidated balance sheet for the WRS Silo as of September 30, 2022, which is the latest balance sheet available. The balance sheet shows $1.36 billion in total assets as of that date. However, because this balance sheet was produced while the Debtors were controlled by Mr. Bankman-Fried, I do not have confidence in it, and the information therein may not be correct as of the date stated.

19. The chart below summarizes certain information regarding the WRS Silo's consolidated assets as reflected in the September 30, 2022 balance sheet:

WRS Silo **Consolidated Assets as of September 30, 2022**	
Current Assets	
Cash and Cash Equivalents	$144,207
Restricted Cash	$267,738
U.S. Dollar Denominated Stablecoins	$68,035
Customer Custodial Funds	$102,225
Accounts Receivable	$2,978
Accounts Receivable, Related Party	$71,563
Loans Receivable	$250,000
Prepaid Expenses and Other Current Assets	$21,448
Crypto Assets Held at Fair Value	$1,026
Total Current Assets	**$929,220**
Property and Equipment, Net	$2,017
Other Non-Current Assets	$429,428
Total Assets	**$1,360,665**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, assets shown reflect the elimination of intercompany entries within and between the WRS Silo and Dotcom Silo.

(3) Restricted cash at the WRS Silo is primarily comprised of approximately $250 million in restricted funds at non-Debtor LedgerX.

(4) Customer custodial fund assets are comprised of fiat customer deposit balances. **Balances of customer crypto assets deposited were not recorded as assets on the balance sheet and are not presented.**

(5) Loans receivable of $250 million consists of a loan by Debtor West Realm Shires Inc. to BlockFi Inc. of $250 million in FTT tokens.

(6) Intangible assets (in the amount of $229 million) are not reflected above. These consist of values attributable to customer relationships and trade names.

(7) Goodwill balance (in the amount of $135 million) is not reflected above.

20. To my knowledge, the WRS Silo Debtors do not have any long-term or funded debt. The WRS Silo Debtors are expected to have significant liabilities arising from crypto assets deposited by customers through the FTX US platform. However, such liabilities are not reflected in the financial statements prepared while these companies were under the control of Mr. Bankman-Fried. The chart below summarizes certain information regarding the WRS Silo's consolidated liabilities as reflected in the September 30, 2022 balance sheet:

WRS Silo **Consolidated Liabilities as of September 30, 2022**	
Current Liabilities	
Accounts Payable and Accrued Expenses	$6,014
Accounts Payable, Related Party	$124,221
Custodial Funds Due to Customers	$102,225
Purchase Consideration Payable	–
Loan Payable	–
Lease Liability, Current	$1,672
Crypto Asset Borrowings at Fair Value	$1,737
Total Current Liabilities	**$235,869**
Lease Liability, Non-Current	$9,399
Deferred Taxes	$20,185
Contract Liability	$887
SAFE Note, Related Party, Non-Current	$50,000
Other Non-Current Liabilities	–
Total Liabilities	**$316,014**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, liabilities shown reflect the elimination of intercompany entries within and between the WRS Silo and Dotcom Silo.

(3) Customer custodial fund liabilities are comprised of fiat customer deposit balances. **Balances of customer crypto assets deposited are not presented.**

21. All Debtors and non-Debtors in the WRS Silo are organized in the State of Delaware, other than non-Debtor FTX Vault Trust Company, which is a South Dakota Trust Company.

C. The Alameda Silo

22. The parent company and primary operating company in the Alameda Silo is Alameda Research LLC, which is organized in the State of Delaware. Before the Petition Date (as defined below), the Alameda Silo operated quantitative trading funds specializing in crypto assets. Strategies included arbitrage, market making, yield farming and trading volatility. The Alameda Silo also offered over-the-counter trading services, and made and managed other debt and equity investments. In short, the Alameda Silo was a "crypto hedge fund" with a diversified business trading and speculating in digital assets and related loans and securities for the account of its owners, Messrs. Bankman-Fried (90%) and Wang (10%).

23. Alameda Research LLC prepared consolidated financial statements on a quarterly basis. To my knowledge, none of these financial statements have been audited. The September 30, 2022 balance sheet for the Alameda Silo shows $13.46 billion in total assets as of its date. However, because this balance sheet was unaudited and produced while the Debtors were controlled by Mr. Bankman-Fried, I do not have confidence in it and the information therein may not be correct as of the date stated.

24. The chart below summarizes certain information regarding the Alameda Silo's consolidated assets as reflected in the September 30, 2022 balance sheet:

Alameda Silo Consolidated Assets as of September 30, 2022	
Current Assets	
Cash and Cash Equivalents	$547,964
Restricted Cash	-
U.S. Dollar Denominated Stablecoins	-
Customer Custodial Funds	-
Investments	$3,976,632
Accounts Receivable	$10,845
Accounts Receivable, Related Party	$427,323
Loans Receivable	$41,607
Loans Receivable, Related Party	$4,102,365
Prepaid Expenses and Other Current Assets	$1,083
Crypto Assets Held at Fair Value	$4,084,886

Total Current Assets	**$13,192,706**
Property and Equipment, Net	$26,763
Other Non-Current Assets	$239,696
Total Assets	**$13,459,165**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, intercompany accounts receivable, accounts payable, loans payable, and loans receivable are not presented.

(3) Related Party Loans Receivable of $4.1 billion at Alameda Research (consolidated) consisted primarily of a loan by Euclid Way Ltd. to Paper Bird Inc. (a Debtor) of $2.3 billion and three loans by Alameda Research Ltd.: one to Mr. Bankman-Fried, of $1 billion; one to Mr. Singh, of $543 million; and one to Ryan Salame, of $55 million.

25. The chart below summarizes certain information regarding the Alameda Silo's consolidated liabilities as reflected in the September 30, 2022 balance sheet:

Alameda Silo Consolidated Liabilities as of September 30, 2022	
Current Liabilities	
Accounts Payable and Accrued Expenses	$916,305
Accounts Payable, Related Party	$75,900
Custodial Funds Due to Customers	$309,634
Purchase Consideration Payable	-
Loans Payable	-
Loans Payable, Related Party	$13,762
Lease Liability, Current	-
Crypto Asset Borrowings at Fair Value	$3,773,979
Total Current Liabilities	**$5,089,579**
Lease Liability, Non-Current	-
Deferred Taxes	-
Contract Liability	-
SAFE Note, Related Party, Non-Current	-
Other Non-Current Liabilities	-
Total Liabilities	**$5,089,579**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, intercompany accounts receivable, accounts payable, loans payable, and loans receivable are not presented.

26. As mentioned above, Alameda Research LLC is organized in the State of Delaware. The other Debtors in the Alameda Silo are organized in Delaware, Korea, Japan, the British Virgin Islands, Antigua, Hong Kong, Singapore, the Seychelles, the Cayman Islands, the Bahamas, Australia, Panama, Turkey and Nigeria.

D. The Ventures Silo

27. The Debtors in the Ventures Silo make and manage private investments. The investments are held in Debtors Clifton Bay Investments, LLC, Clifton Bay Investments Ltd., FTX Ventures Ltd., Island Bay Ventures Inc. and, potentially, affiliated companies.

28. To my knowledge, Debtors Clifton Bay Investments, LLC and FTX Ventures Ltd. prepared financial statements on a quarterly basis. The September 30, 2022 balance sheet for Debtor Clifton Bay Investments LLC shows assets with a total value of $1.52 billion as of its date, and the September 30, 2022 balance sheet for FTX Ventures Ltd. shows assets with a total value of $493 million as of its date. To my knowledge, none of these financial statements have been audited. Because these balance sheets were unaudited and produced while the Debtors were controlled by Mr. Bankman-Fried, I do not have confidence in them, and the information therein may not be correct as of the date stated.

29. I have not been able to locate financial statements for Island Bay Ventures Inc.

30. The chart below summarizes certain information regarding the Ventures Silo's assets as reflected in the September 30, 2022 balance sheets, excluding any assets held by Island Bay Ventures Inc.

Ventures Silo Consolidated Assets as of September 30, 2022		
	Clifton Bay Investments LLC (consolidated)	**FTX Ventures Ltd**
Current Assets		
Cash and Cash Equivalents	$245	$261
Restricted Cash	-	-
U.S. Dollar Denominated Stablecoins	-	-
Customer Custodial Funds	-	-
Investments	$1,492,856	$397,861
Accounts Receivable	-	-
Accounts Receivable, Related Party	$10,200	-

Loans Receivable	$16,810	-
Loans Receivable, Related Party	-	-
Prepaid Expenses and Other Current Assets	-	-
Crypto Assets Held at Fair Value	-	$95,337
Total Current Assets	**$1,520,111**	**$493,459**
Property and Equipment, Net	-	-
Other Non-Current Assets	-	-
Total Assets	**$1,520,111**	**$493,459**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, intercompany accounts receivable, accounts payable, loans payable, and loans receivable are not presented.

31. The chart below summarizes certain information regarding the Ventures Silo's liabilities as reflected in the September 30, 2022 balance sheets excluding any liabilities of Island Bay Ventures Inc.:

Ventures Silo Consolidated Liabilities as of September 30, 2022		
	Clifton Bay Investments LLC (Consolidated)	**FTX Ventures Ltd**
Current Liabilities		
Accounts Payable and Accrued Expenses	$44	-
Accounts Payable, Related Party	$1,519,283	$129,518
Custodial Funds Due to Customers	-	-
Purchase Consideration Payable	-	-
Loans Payable	-	-
Loans Payable, Related Party	-	$362,915
Lease Liability, Current	-	-
Crypto Asset Borrowings at Fair Value	-	-
Total Current Liabilities	**$1,519,326**	**$492,432**
Lease Liability, Non-Current	-	-
Deferred Taxes	-	-
Contract Liability	-	-
SAFE Note, Related Party, Non-Current	-	-
Other Non-Current Liabilities	-	-
Total Liabilities	**$1,519,326**	**$492,432**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, intercompany accounts receivable, accounts payable, loans payable, and loans receivable are not presented.

(3) Related Party Accounts Payable at Clifton Bay Investments LLC consists of four related-party balances: one with Debtor Alameda Research Ltd, of $1,400 million; one with Debtor Alameda Research LLC, of $68.6 million; one with Alameda Ventures Ltd, of $38.5 million; and one with Debtor West Realm Shires Services Inc. of $2.25 million.

(4) Customer custodial fund liabilities are comprised of fiat customer deposit balances. **Balances of customer crypto assets deposited are not presented**.

32. All Debtors in the Ventures Silo are organized in the State of Delaware or the British Virgin Islands.

E. The Dotcom Silo

33. The Dotcom Silo includes FTX.com, the trade name for the business conducted by the parent company in the Dotcom Silo, FTX Trading Ltd., which is organized in Antigua. FTX.com is a digital asset trading platform and exchange. It was founded by Messrs. Bankman-Fried, Wang and Singh and commenced operations in May 2019. The Dotcom Silo also holds certain marketplace licenses and registrations in certain non-U.S. jurisdictions, including the European Union and Japan. The FTX.com platform is not available to U.S. users.

34. In addition to its core digital asset exchange, the Dotcom Silo offered an off-exchange portal that enabled users to connect and request quotes for spot digital assets and trade directly. The portal enabled users to lend their digital assets to other users for spot trading and matched users wanting to borrow with those willing to lend.

35. The FTX.com platform grew quickly since its launch to become one of the largest cryptocurrency exchanges in the world. Mr. Bankman-Fried claimed that, by the end of 2021, around $15 billion of assets were on the platform, which according to him handled approximately 10% of global volume for crypto trading at the time. Mr. Bankman-Fried also claimed that FTX.com, as of July 2022, had "millions" of registered users. These figures have not been verified by my team.

36. The Dotcom Silo's unaudited consolidated balance sheet as of September 30, 2022 is the latest balance sheet that was provided to me with respect to the Dotcom Silo. It shows total assets of $2.25 billion as of September 30, 2022. Because such balance sheet was

produced while the Debtors were controlled by Mr. Bankman-Fried, I do not have confidence in it, and the information therein may not be correct as of the date stated.

37. The chart below summarizes certain information regarding the Dotcom Silo's consolidated assets as reflected in the September 30, 2022 balance sheet:

Dotcom Silo Consolidated Assets as of September 30, 2022	
Current Assets	
Cash and Cash Equivalents	$483,724
Restricted Cash	$10,188
U.S. Dollar Denominated Stablecoins	$1,140,795
Customer Custodial Funds	–
Accounts Receivable	$9,459
Accounts Receivable, Related Party	$188,155
Loans Receivable	$103,949
Prepaid Expenses and Other Current Assets	$42,661
Crypto Assets Held at Fair Value	$659
Total Current Assets	**$1,979,590**
Property and Equipment, Net	$256,996
Other Non-Current Assets	$22,148
Total Assets	**$2,258,734**

(1) Amounts shown in thousands of U.S. Dollars.

(2) The balance sheet for non-Debtor FTX Digital Markets Ltd. is consolidated to Debtor FTX Trading Ltd.'s balance sheet. The September 30, 2022 Balance Sheet of non-Debtor FTX Digital Markets Ltd. reflects an asset position of $149,336, as follows: Cash and Cash Equivalents ($82,564), Restricted Cash ($10,000), U.S. Dollar Denominated Stablecoins ($63), Related Party Receivables ($45,944), Prepaid Expenses and Other Current Assets ($4,922), Property and Equipment, Net ($5,565) and Other Non-Current Assets ($278) (amounts in thousands of U.S. Dollars).

(3) Non-debtor FTX Digital Markets Ltd. has a net intercompany accounts payable of $30 million due to entities controlled by Debtor FTX Trading Ltd.

(4) In the above table, assets shown reflect the elimination of intercompany entries within and between the WRS Silo and Dotcom Silo.

(5) Customer custodial fund assets are comprised of fiat customer deposit balances. **Balances of customer crypto assets deposited are not presented.**

(6) Loans Receivable of $250 million at FTX US consists of a loan to BlockFi Inc. of $250 million in FTT tokens.

(7) Intangible assets (in the amount of $343 million) are not reflected above. These consist of values attributable to customer relationships and trade names.

(8) Goodwill balance (in the amount of $359 million) is not reflected above.

38. To my knowledge, the Dotcom Silo Debtors do not have any long-term or funded debt. The Dotcom Silo Debtors may have significant liabilities to customers through the

FTX.com platform. However, such liabilities are not reflected in the financial statements prepared by these companies while they were under the control of Mr. Bankman-Fried. The chart below summarizes certain information regarding the Dotcom Silo's consolidated liabilities as reflected in the September 30, 2022 balance sheet:

Dotcom Silo Consolidated Liabilities as of September 30, 2022	
Current Liabilities	
Accounts Payable and Accrued Expenses	$38,970
Accounts Payable, Related Party	$125,626
Custodial Funds Due to Customers	–
Purchase Consideration Payable	$26,970
Loan Payable	$124,298
Lease Liability, Current	$23
Crypto Asset Borrowings at Fair Value	$149,723
Total Current Liabilities	**$465,610**
Lease Liability, Non-Current	–
Deferred Taxes	–
Contract Liability	–
SAFE Note, Related Party, Non-Current	–
Other Non-Current Liabilities	$46
Total Liabilities	**$465,656**

(1) Amounts shown in thousands of U.S. Dollars.

(2) In the above table, liabilities shown reflect the elimination of intercompany entries within and between the WRS Silo and Dotcom Silo.

(3) The balance sheet for non-Debtor FTX Digital Markets Ltd. is consolidated to Debtor FTX Trading Ltd.'s balance sheet. The September 30, 2022 Balance Sheet of non-Debtor FTX Digital Markets Ltd. reflects total liabilities in the amount of $1,278, as follows: Accounts Payable and Accrued Expenses ($1,259), Accounts Payable, Related Party ($19) (amounts in thousands of U.S. Dollars).

(4) Customer custodial fund liabilities are comprised of fiat customer deposit balances. **Balances of customer crypto assets deposited were not recorded as assets on the balance sheet and are not presented.**

39. The Debtors in the Dotcom Silo are organized in jurisdictions around the world, with the parent company FTX Trading Ltd. organized in Antigua. The Debtors in the Dotcom Silo also own 100% of the equity interests in over a dozen non-Debtor companies.

II. EVENTS LEADING TO CHAPTER 11 FILING

40. The Debtors faced a severe liquidity crisis that necessitated the filing of these Chapter 11 Cases on an emergency basis on November 11, 2022, and in the case of Debtor

West Realm Shires Inc., on November 14, 2022 (collectively, the "Petition Date"). In the days leading up to the Petition Date, certain of the circumstances described in Part III below became known to a broader set of executives of the FTX Group beyond Mr. Bankman-Fried and members of his inner circle. Questions arose about Mr. Bankman-Fried's leadership and the handling of the Debtors' complex array of assets and businesses.

41. As the situation became increasingly dire, Sullivan & Cromwell and Alvarez & Marsal were engaged to provide restructuring advice and services to the Debtors.

42. On November 10, 2022, the Securities Commission of the Bahamas (the "SCB") took action to freeze assets of non-Debtor FTX Digital Markets Ltd., a service provider to FTX Trading Ltd. and the employer of certain current and former executives and staff in the Bahamas. Mr. Brian Simms, K.C. was appointed as provisional liquidator of FTX Digital Markets Ltd. on a sealed record. The provisional liquidator for this Bahamas subsidiary has filed a chapter 15 petition seeking recognition of the provisional liquidation proceeding in the Bankruptcy Court for the Southern District of New York.

43. In addition, in the first hours of November 11, 2022 EST, the directors of non-Debtors FTX Express Pty Ltd and FTX Australia Pty Ltd., both Australian entities, appointed Messrs. Scott Langdon, John Mouawad and Rahul Goyal of KordaMentha Restructuring as voluntary administrators.

44. At the same time, negotiations were being held between certain senior individuals of the FTX Group and Mr. Bankman-Fried concerning the resignation of Mr. Bankman-Fried and the commencement of these Chapter 11 Cases. Mr. Bankman-Fried consulted with numerous lawyers, including lawyers at Paul, Weiss, Rifkind, Wharton & Garrison LLP, other legal counsel and his father, Professor Joseph Bankman of Stanford Law

School. A document effecting a relinquishment of control was prepared and comments from Mr. Bankman-Fried's team incorporated. At approximately 4:30 a.m. EST on Friday, November 11, 2022, after further consultation with his legal counsel, Mr. Bankman-Fried ultimately agreed to resign, resulting in my appointment as the Debtors' CEO. I was delegated all corporate powers and authority under applicable law, including the power to appoint independent directors and commence these Chapter 11 Cases on an emergency basis.

45. Other than the proceedings in the Bahamas and Australia, to my knowledge, no other Debtor or non-Debtor subsidiary is subject to other insolvency proceedings at this time.

III. ACTION TAKEN SINCE MR. BANKMAN-FRIED'S DEPARTURE

A. New Governance Structure

46. Many of the companies in the FTX Group, especially those organized in Antigua and the Bahamas, did not have appropriate corporate governance. I understand that many entities, for example, never had board meetings.

47. The following new independent directors (the "Directors") have been appointed as directors of the primary companies in the FTX Group:

(a) **WRS Silo: Mitchell I. Sonkin:** Mitchell Sonkin is currently a Senior Advisor to MBIA Insurance Corporation in connection with the restructuring of the Firm's insured portfolio exposure of the Commonwealth of Puerto Rico's $72 billion of outstanding debt. He is also currently Chairman of the Board of the ResCap Liquidating Trust, successor to ResCap and GMAC Mortgage Corporations. Before joining MBIA, Mr. Sonkin was a senior partner at the international law firm, King & Spalding, where he was co-chair of King & Spalding's Financial Restructuring Group and a member of the firm's Policy Committee. He has over 40 years of experience in U.S. and international bond issuances, corporate reorganizations, bankruptcies and other debt restructurings and has served as a bankruptcy-court-appointed examiner. In particular, he has played a significant role in numerous municipal, utility, insurance, airline, healthcare debt and international debt restructurings including the Anglo/French Euro Tunnel debt reorganization.

(b) **Alameda Silo: Matthew R. Rosenberg:** Mr. Rosenberg is a Partner at Lincoln Park Advisors, a financial advisory firm that he founded in 2014. He has more than 25 years of restructuring, corporate finance, principal investing, operating and board experience. Prior to founding Lincoln Park Advisors, he was a partner at the restructuring and investment banking firm Chilmark Partners, a partner in two private equity funds, the Zell/Chilmark Fund and Chilmark Fund II, the Chief Restructuring Officer of The Wellbridge Company and a member of multiple corporate boards. His restructuring advisory experience includes such companies as OSG, Supermedia, Nortel, Trinity Coal, USG Corporation, JHT Holdings, Inc., Covanta Energy, Sirva, Lodgian, Inc., ContiGroup Companies, Inc., Fruit of the Loom, Ltd. and Recycled Paper Greetings.

(c) **Ventures Silo: Rishi Jain:** Mr. Jain is a Managing Director and Co-Head of the Western Region of Accordion, a financial and technology consulting firm focused on the private equity industry. He has more than 25 years of experience supporting management teams and leading finance and operations initiatives in both stressed and distressed environments. Prior to joining Accordion, Mr. Jain was part of Alvarez & Marsal's corporate restructuring and turnaround practice for over 10 years and served in a variety of senior financial operating roles. His most notable assignments have included helping lead the restructuring, liquidation and wind down of Washington Mutual and its predecessor entity, WMI Liquidating Trust. He also navigated the restructuring of Global Geophysical Services in its chapter 11 and eventually the liquidation and wind down in its second chapter 11 filing.

(d) **Dotcom Silo: The Honorable Joseph J. Farnan (Lead Independent Director):** Mr. Farnan served as a United States District Judge for the District of Delaware from 1985 to 2010. He served as Chief Judge from 1997-2001. During his tenure, Mr. Farnan presided over numerous bench and jury trials involving complex commercial disputes. Prior to his appointment to the federal bench, Mr. Farnan was appointed to several positions in local, state and the federal government returning to private practice in 2010 with the formation of Farnan LLP, a law firm focused on complex commercial matters, including chapter 11 proceedings, securities litigation, antitrust litigation and patent litigation. Additionally, Mr. Farnan serves as an arbitrator, mediator, independent director and trustee of businesses contemplating or filing chapter 11 bankruptcy.

(e) **Dotcom Silo: Matthew A. Doheny:** Mr. Doheny is President of North Country Capital LLC, an advisory and investment firm focused on challenging advisory assignments and investing private investment portfolios in special situation opportunities. He has held this position since January 2011. Mr. Doheny has served on the board of directors or as Chief Restructuring Officer of numerous stressed and distressed companies, including Yellow Corp., MatlinPatterson, GMAC Rescap and Eastman

Kodak. He was also Managing Director and Head of Special Situations Investing at HSBC Securities Inc. from 2015 to 2017. Previously, Mr. Doheny served as Portfolio Manager in Special Situations at Fintech Advisory Inc. from 2008 to 2010 and as Managing Director of the Distressed Products Group at Deutsche Bank Securities Inc. from 2000 to 2008.

48. The appointment of the Directors will provide the FTX Group with appropriate corporate governance for the first time.

49. The Directors intend to hold joint board meetings of the Debtors on matters of common interest, including (a) the implementation of controls, (b) asset protection and recovery, (c) the investigation into claims against the founders and third parties, (d) cooperation with insolvency proceedings of subsidiary companies in other jurisdictions and (e) the maximization of value for all stakeholders through the eventual reorganization or sale of the Debtors' complex array of businesses, investments and property around the world. The Directors will implement appropriate procedures for the resolution of any conflicts of interest among the Silos and, if necessary, within the Silos as the case progresses, including the potential engagement of independent counsel to represent various Debtors in the resolution of intercompany claims against other Debtors. I expect there to be a multitude of intercompany claims that will benefit from fair resolution under the rules and conventions of U.S. chapter 11 practice in the District of Delaware for complex, multi-Debtor cases. For the time being, my belief is that all stakeholders are best served by a coordinated and centralized administration.

B. Cash Management

50. The FTX Group did not maintain centralized control of its cash. Cash management procedural failures included the absence of an accurate list of bank accounts and account signatories, as well as insufficient attention to the creditworthiness of banking partners

around the world. Under my direction, the Debtors are establishing a centralized cash management system with proper controls and reporting mechanisms.

51. During these Chapter 11 Cases, cash that the Debtors are able to locate and transfer to the United States without adverse consequences, including substantially all proceeds of the global reorganization effort, will be deposited into financial institutions in the United States that are approved depository institutions in accordance with the U.S. Trustee Guidelines. Each Silo will have a centralized cash pool, and the Debtors will implement appropriate arrangements for allocating costs across the various Silos and Debtors. The Debtors expect to file promptly a Cash Management Motion that will describe the new cash management system in more detail.

52. Because of historical cash management failures, the Debtors do not yet know the exact amount of cash that the FTX Group held as of the Petition Date. The Debtors are working with Alvarez & Marsal to verify all cash positions. To date, it has been possible to approximate the following balances as of the Petition Date based on available books and records:

Entity	Unrestricted Cash	Custodial Cash	Other Restricted Cash	Total Cash
Debtor Entities				
FTX EU Ltd	$1,250,848	$47,925,646	$175,832	$49,352,327
West Realm Shires Services Inc.	$32,233,606	$14,596,119	$1,270,700	$48,100,425
West Realm Shires Inc.	$35,411,619	-	-	$35,411,619
Paper Bird Inc	$7,906,893	-	-	$7,906,893
FTX Exchange FZE	$1,812,563	-	$4,000,000	$5,812,563
Ledger Holdings Inc.	$4,098,480	-	-	$4,098,480
FTX TURKEY TEKNOLOJİ VE TİCARET ANONİM ŞİRKET	$36,682	$3,069,526	-	$3,106,208
FTX Europe AG	$2,979,584	-	-	$2,979,584
FTX Trading Ltd	$375,726	$2,600,324	-	$2,976,050
Maclaurin Investments Ltd.	$2,529,814	-	-	$2,529,814
Blockfolio, Inc.	$2,396,067	-	-	$2,396,067
Ledger Prime LLC	$2,230,765	-	-	$2,230,765
Crypto Bahamas LLC	$900,000	-	-	$900,000
FTX Ventures Ltd	$779,542	-	-	$779,542
West Realm Shires Financial Services Inc.	$576,831	-	-	$576,831
FTX Lend Inc.	$484,738	-	-	$484,738
FTX Trading GmbH	$146,059	-	-	$146,059
FTX Switzerland GmbH	$16,799	-	-	$16,799

Entity	Unrestricted Cash	Custodial Cash	Other Restricted Cash	Total Cash
Total Debtor Entities	**$96,166,614**	**$68,191,615**	**$5,446,532**	**$169,804,762**
Non-Debtor Entities				
LedgerX LLC	$13,644,269	$24,103,085	$265,603,056	$303,350,409
FTX Digital Markets Ltd	-	-	$49,999,600	$49,999,600
Embed Clearing LLC.	-	-	$29,978,776	$29,978,776
FTX Philanthropy Inc	$10,877,387	-	-	$10,877,387
Embed Financial Technologies Inc	$395,371	-	-	$395,371
Total Non-Debtor Entities	**$24,917,027**	**$24,103,085**	**$345,581,432**	**$394,601,543**
Total	**$121,083,641**	**$92,294,700**	**$351,027,964**	**$564,406,305**

53. The Debtors have been in contact with banking institutions that they believe hold or may hold Debtor cash. These banking institutions have been instructed to freeze withdrawals and alerted not to accept instructions from Mr. Bankman-Fried or other signatories. Proper signature authority and reporting systems are expected to be arranged shortly.

54. Effective cash management also requires liquidity forecasting, which I understand was also generally absent from the FTX Group historically. The Debtors are putting in place the systems and processes necessary for Alvarez & Marsal to produce a reliable cash forecast as well as the cash reporting required for Monthly Operating Reports under the Bankruptcy Code.

C. Financial Reporting

55. The FTX Group received audit opinions on consolidated financial statements for two of the Silos – the WRS Silo and the Dotcom Silo – for the period ended December 31, 2021. The audit firm for the WRS Silo, Armanino LLP, was a firm with which I am professionally familiar. The audit firm for the Dotcom Silo was Prager Metis, a firm with which I am not familiar and whose website indicates that they are the "first-ever CPA firm to officially open its Metaverse headquarters in the metaverse platform Decentraland."[4]

[4] https://pragermetis.com/news/prager-metis-opens-first-ever-cpa-firm-metaverse/.

56. I have substantial concerns as to the information presented in these audited financial statements, especially with respect to the Dotcom Silo. As a practical matter, I do not believe it appropriate for stakeholders or the Court to rely on the audited financial statements as a reliable indication of the financial circumstances of these Silos.

57. The Debtors have not yet been able to locate any audited financial statements with respect to the Alameda Silo or the Ventures Silo.

58. The Debtors are locating and securing all available financial records but expect it will be some time before reliable historical financial statements can be prepared for the FTX Group with which I am comfortable as Chief Executive Officer. The Debtors do not have an accounting department and outsource this function.

D. Human Resources

59. The FTX Group's approach to human resources combined employees of various entities and outside contractors, with unclear records and lines of responsibility. At this time, the Debtors have been unable to prepare a complete list of *who* worked for the FTX Group as of the Petition Date, or the terms of their employment. Repeated attempts to locate certain presumed employees to confirm their status have been unsuccessful to date.

60. Nevertheless, there is a core team of dedicated employees at the FTX Group who have stayed focused on their jobs during this crisis and with whom I have established appropriate lines of authority and working relationships. The Debtors continue to review personnel issues but I expect, based on my experience and the nature of the Debtors' business, that a large number of employees of the Debtors will need to continue to work for the Debtors for the foreseeable future in order to establish accountability, preserve value and maximize stakeholder recoveries after the departure of Mr. Bankman-Fried. As Chief Executive Officer, I am thankful for the extraordinary efforts of this group of employees, who despite difficult

personal circumstances, have risen to the occasion and demonstrated their critical importance to the Debtors.

61. The Debtors are preparing one or more motions to address issues relating to continuing employees and contractors. The Debtors also may hire new employees and officers with turnaround or other relevant experience in core functions where I determine that new leadership is required. I anticipate that the Debtors will be able to file these motions in the coming days.

E. Disbursement Controls

62. The Debtors did not have the type of disbursement controls that I believe are appropriate for a business enterprise. For example, employees of the FTX Group submitted payment requests through an on-line 'chat' platform where a disparate group of supervisors approved disbursements by responding with personalized emojis.

63. In the Bahamas, I understand that corporate funds of the FTX Group were used to purchase homes and other personal items for employees and advisors. I understand that there does not appear to be documentation for certain of these transactions as loans, and that certain real estate was recorded in the personal name of these employees and advisors on the records of the Bahamas.

64. The Debtors now are implementing a centralized disbursement approval process that reports to me as Chief Executive Officer.

F. Digital Asset Custody

65. The FTX Group did not keep appropriate books and records, or security controls, with respect to its digital assets. Mr. Bankman-Fried and Mr. Wang controlled access to digital assets of the main businesses in the FTX Group (with the exception of LedgerX, regulated by the CFTC, and certain other regulated and/or licensed subsidiaries). Unacceptable

management practices included the use of an unsecured group email account as the root user to access confidential private keys and critically sensitive data for the FTX Group companies around the world, the absence of daily reconciliation of positions on the blockchain, the use of software to conceal the misuse of customer funds, the secret exemption of Alameda from certain aspects of FTX.com's auto-liquidation protocol, and the absence of independent governance as between Alameda (owned 90% by Mr. Bankman-Fried and 10% by Mr. Wang) and the Dotcom Silo (in which third parties had invested).

66. The Debtors have located and secured only a fraction of the digital assets of the FTX Group that they hope to recover in these Chapter 11 Cases. The Debtors have secured in new cold wallets approximately $740 million of cryptocurrency that the Debtors believe is attributable to either the WRS, Alameda and/or Dotcom Silos. The Debtors have not yet been able to determine how much of this cryptocurrency is allocable to each Silo, or even if such an allocation can be determined. These balances exclude cryptocurrency not currently under the Debtors' control as a result of (a) at least $372 million of unauthorized transfers initiated on the Petition Date, during which time the Debtors immediately began moving cryptocurrency into cold storage to mitigate the risk to the remaining cryptocurrency that was accessible at the time, (b) the dilutive 'minting' of approximately $300 million in FTT tokens by an unauthorized source after the Petition Date and (c) the failure of the co-founders and potentially others to identify additional wallets believed to contain Debtor assets.

67. In response, the Debtors have engaged forensic analysts to identify potential Debtor assets on the blockchain, cybersecurity professionals to identify the parties responsible for the unauthorized transactions on and after the Petition Date and investigators to begin the process of identifying what may be very substantial transfers of Debtor property in the

days, weeks and months prior to the Petition Date. The Debtors' team includes business, accounting, forensic, technical and legal resources that I believe are among the best in the world at these activities. It is my expectation that the Debtors will require assistance from the Court with respect to these matters as the investigation and these Chapter 11 Cases continue.

68. Although the investigation has only begun and must run its course, it is my view based on the information obtained to date, that many of the employees of the FTX Group, including some of its senior executives, were not aware of the shortfalls or potential commingling of digital assets. Indeed, I believe some of the people most hurt by these events are current and former employees and executives, whose personal investments and reputations have suffered. These are many of the same people whose work will be necessary to ensure the maximization of value for all stakeholders going forward.

G. Custody of Other Assets and Investments

69. The FTX Group had billions in investments other than cryptocurrency, as suggested above in the descriptions of the four Silos. However, the main companies in the Alameda Silo and the Ventures Silo did not keep complete books and records of their investments and activities.

70. The Debtors are creating a balance sheet and other financial statements for the Alameda Silo and the Ventures Silo as of the Petition Date. The Debtors are doing so from the 'bottom-up' by using the records of cash transactions at the Debtors, and also are reviewing various third-party sources to locate investments.

H. Information and Retention of Documents

71. One of the most pervasive failures of the FTX.com business in particular is the absence of lasting records of decision-making. Mr. Bankman-Fried often communicated

by using applications that were set to auto-delete after a short period of time, and encouraged employees to do the same.

72. The Debtors are writing things down. The investigative effort underway is led by myself and a team at Sullivan & Cromwell that reports directly to me, including a former Director of Enforcement at the SEC, a former Director of Enforcement at the CFTC, and a former Chief of the Complex Frauds and Cybercrime Unit of the United States Attorney's Office for the Southern District of New York. I regard ensuring the comprehensiveness, professionalism and integrity of this investigation as an essential part of my job as Chief Executive Officer.

73. Transparency with regulators around the world is an important objective for the Debtors. Since Friday, the Debtors have been in contact with dozens of regulators throughout the United States and around the world, and will continue to be as these cases continue.

I. Regulated and Licensed Subsidiaries

74. The FTX Group included regulated or licensed subsidiaries in many jurisdictions that may or may not have valuable going concern franchises. The Debtors will soon be taking efforts to preserve these subsidiary businesses to the extent practicable under the circumstances. The Debtors also are engaging a leading investment bank to assist the Debtors in valuing these businesses and potentially conducting sales efforts.

J. Access to Data

75. The Debtors have cryptocurrency, digital assets and other critically sensitive data in repositories that have been the subject of unauthorized attempts to access. The Debtors have implemented certain defensive measures. The Debtors have been advised that attempts to access this property of the estate may create a risk of its loss to unauthorized persons.

The Debtors expect to seek special relief from the Court to authorize measures to access this information as safely as possible. The Debtors are unable to create a list of their top 50 creditors that includes customers without access to the data repositories at issue, and may seek related relief from the Court as well if the problem cannot be promptly resolved.

K. Corporate Communications

76. Finally, and critically, the Debtors have made clear to employees and the public that Mr. Bankman-Fried is not employed by the Debtors and does not speak for them. Mr. Bankman-Fried, currently in the Bahamas, continues to make erratic and misleading public statements. Mr. Bankman-Fried, whose connections and financial holdings in the Bahamas remain unclear to me, recently stated to a reporter on Twitter: "F*** regulators they make everything worse" and suggested the next step for him was to "win a jurisdictional battle vs. Delaware".

I declare under penalty of perjury that the foregoing is true and correct.

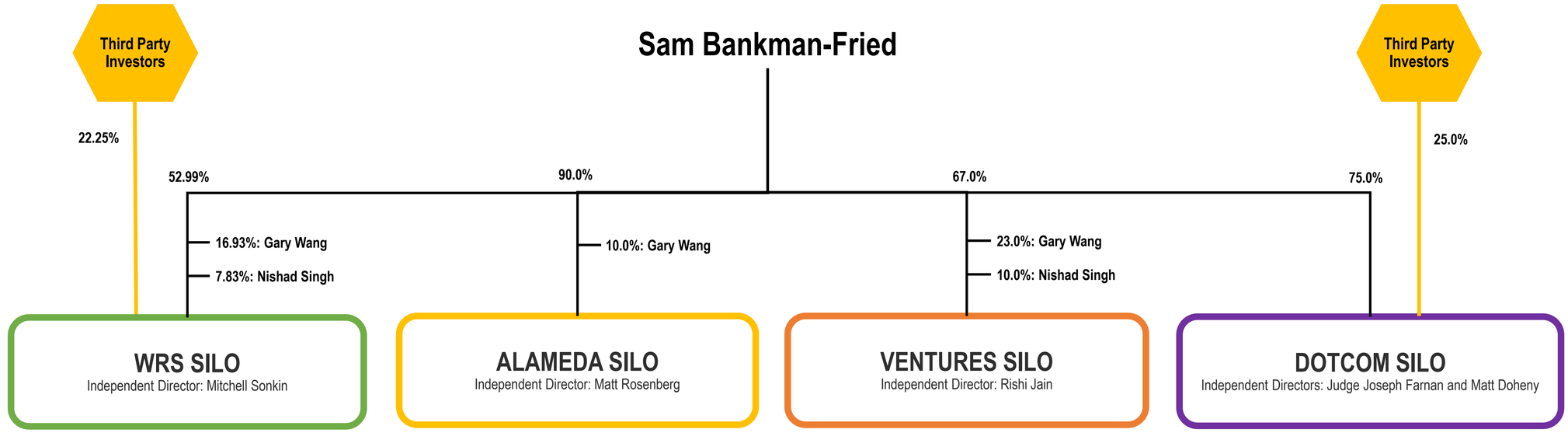
Dated: November 17, 2022

/s/ John J. Ray III
Name: John J. Ray III
Title: Chief Executive Officer

Exhibit A

Summary of the Silos and Indicative Assets

FOUR SILOS FOR RECOVERY PURPOSES



Indicative Assets by Silo

- Cash and Cash Equivalents
- Cryptocurrency
- FTX US
- LedgerX
- FTX Derivatives
- FTX Capital Markets
- Embed Clearing
- FTX Vault
- FTX Gaming
- FTX NFTs
- BlockFi Loans

- Cash and Cash Equivalents
- Cryptocurrency
- Other Digital Assets
- Treasuries
- Crypto ETFs
- Venture Investments
  - *Genesis Digital Assets*
  - *Modulo Capital*
  - *Pionic (Toss)*
  - *Others*

- Venture Investments
  - *Anthropic*
  - *K5*
  - *Dave Inc.*
  - *Sequoia Capital*
  - *Mysten Labs*
  - *Others*

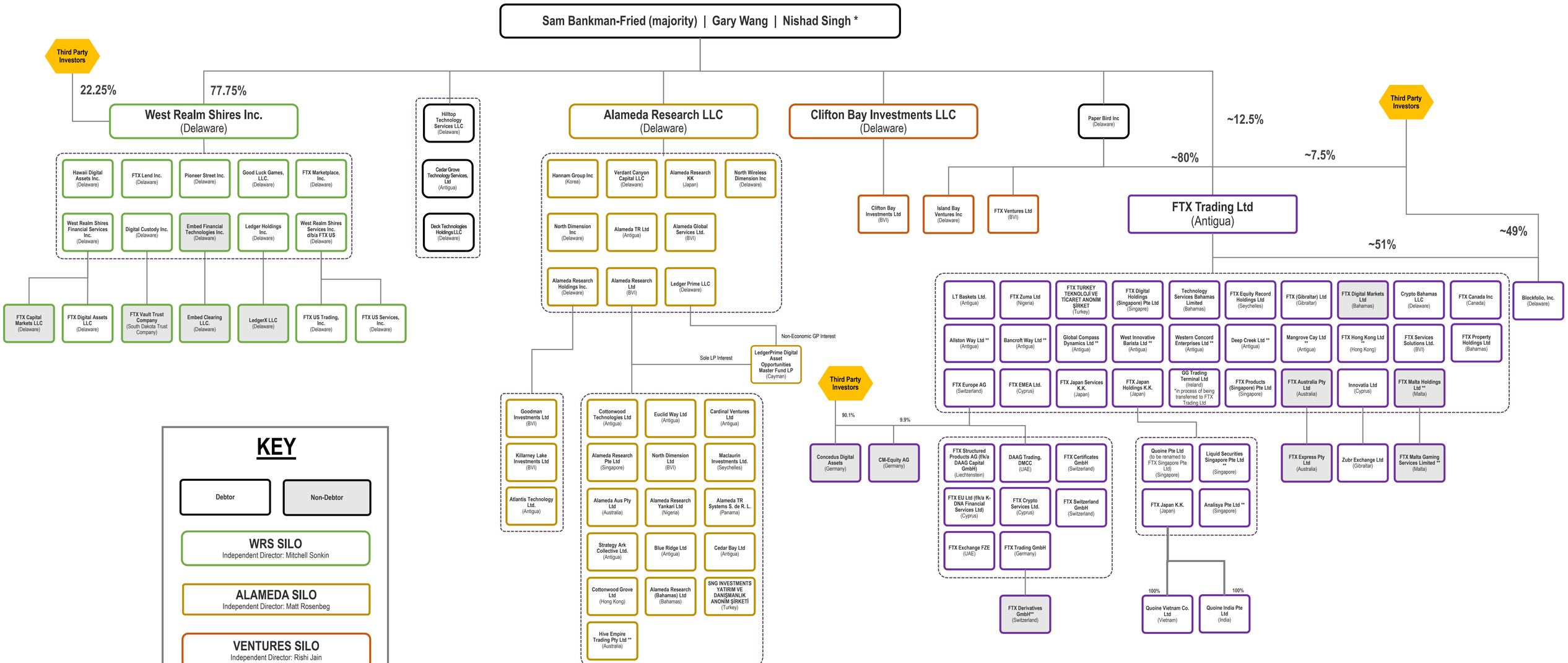
- Cash and Cash Equivalents
- Cryptocurrency
- FTX.com
- Real Estate
- Licensed Subsidiaries in Non-US Jurisdictions

Exhibit B

Preliminary Corporate Structure Chart

PRELIMINARY ORGANIZATIONAL CHART

Last updated: Draft of November 17, 2022



KEY

- Debtor
- Non-Debtor

WRS SILO
Independent Director: Mitchell Sonkin

ALAMEDA SILO
Independent Director: Matt Rosenbeg

VENTURES SILO
Independent Director: Rishi Jain

DOTCOM SILO
Independent Directors: Judge Joseph Farnan and Matt Doheny

* Percentages directly held by each of Sam Bankman-Fried, Gary Wang and Nishad Singh in individual entities varies.
** Indicates non-operational subsidiary entity.

TAB 23

Genesis Global HoldCo, LLC, et al., Case No. 23-10063 (Bankr. S.D.N.Y.) Doc. No. 2

CLEARY GOTTLIEB STEEN & HAMILTON LLP
Sean A. O'Neal
Jane VanLare
One Liberty Plaza
New York, New York 10006
Telephone: 212-225-2000
Facsimile: 212-225-3999

Proposed Counsel to the Debtors and Debtors-in-Possession

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	:	Chapter 11
Genesis Global Holdco, LLC,	:	Case No. 23-10063
Debtor.	:	
Tax I.D. No. 38-4058219	:	
In re	:	Chapter 11
Genesis Global Capital, LLC,	:	Case No. 23-10064
Debtor.	:	
Tax I.D. No. 37-1878564	:	
In re	:	Chapter 11
Genesis Asia Pacific Pte. Ltd.	:	Case No. 23-10065
Debtor.	:	
Tax I.D. 202002164R (Singapore UEN)	:	

DEBTORS' MOTION FOR ENTRY OF AN ORDER DIRECTING JOINT ADMINISTRATION OF THEIR CHAPTER 11 CASES ("JOINT ADMINISTRATION MOTION")

Genesis Global Holdco, LLC ("Holdco") and its above-captioned debtors and debtors-in-possession (collectively, the "Debtors" and these cases, the "Chapter 11 Cases") hereby file this motion (the "Motion"), seeking entry of an order substantially in the form attached hereto as Exhibit A, directing joint administration and procedural consolidation of their related Chapter 11 Cases and granting the Debtors such other and further relief as the Court deems just and proper. A detailed description of the Debtors and their businesses, and the facts and circumstances supporting this Motion and the Debtors' Chapter 11 Cases (as defined herein), is set forth in the *Declaration of A. Derar Islim in Support of First Day Motions and Applications in Compliance with Local Rule 1007-2* (the "Islim Declaration"), the *Declaration of Paul Aronzon in Support of First Day Motions and Applications in Compliance with Local Rule 1007-2* (the "Aronzon Declaration"), and the *Declaration of Michael Leto in Support of First Day Motions and Applications in Compliance with Local Rule 1007-2* (the "Leto Declaration," and along with the Islim Declaration and the Aronzon Declaration, the "First Day Declarations") [1], filed contemporaneously herewith. In further support of this Motion, the Debtors respectfully state as follows:

JURISDICTION AND VENUE

1. The United States Bankruptcy Court for the Southern District of New York (the "Court") has jurisdiction to consider this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the Amended Standing Order of Reference from the United States District Court for the Southern District of New York dated January 31, 2012 (Preska, C.J.). Venue is proper pursuant to 28 U.S.C.

[1] Capitalized terms not defined herein have the meaning ascribed to them in the First Day Declarations.

§§ 1408 and 1409. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b). The statutory predicates for the relief requested herein are sections 105(a) and 342 of the Bankruptcy Code, rule 105(b) of the Federal Rules of Bankruptcy Procedure and rule 9013-1(a) of the Local Bankruptcy Rules for the Southern District of New York.

BACKGROUND

2. Holdco (together with the other Debtors and Holdco's Non-Debtor Subsidiaries, the "Company") and its non-Debtor affiliate Genesis Global Trading, Inc. ("GGT") provide lending and borrowing, spot trading, derivatives and custody services for digital assets and fiat currency. The Debtors engage in lending, borrowing and certain trading services, while the Non-Debtor Subsidiaries engage in derivatives, custody and most of the Company's trading services. Holdco is a sister company of GGT and 100% owned by Digital Currency Group, Inc. ("DCG").

3. Over the past few months, the digital asset industry has experienced tremendous dislocation. The collapse of LUNA and TerraUSD and subsequent liquidation of 3AC signalled the onset of a new "crypto winter" and a growing industry-wide reluctance to do business with digital asset companies. As market conditions worsened, other companies faced financial difficulties, including Celsius Network LLC and certain affiliates and Voyager Digital Holdings, Inc. and certain affiliates, which filed for Chapter 11 in July 2022. Most recently, FTX Trading Ltd. ("FTX"), Alameda Research Ltd. ("Alameda") and certain affiliates (together with FTX and Alameda, the "FTX Entities") filed for Chapter 11 bankruptcy proceedings.

4. These drastic market shifts have decreased investor confidence in the digital asset markets and severely and adversely impacted the Company's business. This "run on the bank" following the FTX Entities' collapse in early November severely impacted the Company's available liquidity. As a result of the unprecedented number and size of the loan calls, on

November 16, 2022, GGC and GAP paused all lending and borrowing to preserve the Debtors' estates, ensure fair distribution and begin discussions with our stakeholders.

5. Over the past two months, the Debtors and their advisors have engaged in extensive negotiations with various advisors to creditor groups to explore strategic solutions. In addition, the Debtors have undertaken cost-saving and liquidity-preserving measures. As a result of those efforts, the Debtors have determined that an in-court process is the best path to continue their efforts to reach a consensual resolution and maximize value for the Debtors' stakeholders.

6. On January 19, 2023, each of the Debtors filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code (the date of such filing, the "Petition Date"). The Debtors are operating their businesses as debtors-in-possession under sections 1107(a) and 1108 of the Bankruptcy Code. No trustee, examiner or official committee of unsecured creditors has been appointed in the Debtors' Chapter 11 Cases.

7. Additional information regarding the Debtors' business, capital structure and the circumstances leading to the commencement of these Chapter 11 Cases is set forth in the First Day Declarations.

8. While the Company's discussions with advisors to various creditor groups and DCG have been very productive in narrowing issues, they have not yet achieved a global resolution. Accordingly, the Debtors commenced the Chapter 11 Cases to continue their efforts towards a consensual resolution through a transparent, court supervised process. To that end, the Debtors are concurrently filing a proposed plan of reorganization, which will be amended as necessary to reflect the results of our continued negotiations.

RELIEF REQUESTED

9. By this Motion, the Debtors seek entry of an order directing joint administration of the Chapter 11 Cases for procedural purposes only. Specifically, the Debtors request that the Court

maintain one file, one docket and one service list for all of the Chapter 11 Cases under the case of Genesis Global Holdco, LLC, and that the Chapter 11 Cases be administered under the following caption:

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	Chapter11
Genesis Global Holdco, LLC, *et al.*,[1]	Case No.: 23-10063
Debtors.	Jointly Administered

[1] The Debtors in these Chapter 11 Cases, along with the last four digits of each Debtor's tax identification number (as applicable), are: Genesis Global Holdco, LLC (8219); Genesis Global Capital, LLC (8564); Genesis Asia Pacific Pte. Ltd. (2164R). For the purpose of these Chapter 11 Cases, the service address for the Debtors is 250 Park Avenue South, 5th Floor, New York, NY 10003.

10. The Debtors further request that the Court order that the foregoing caption satisfies the requirements set forth in section 342(c)(1) of the Bankruptcy Code.

BASIS FOR RELIEF

11. Bankruptcy Rule 1015(b) provides, in pertinent part, that "[i]f . . . two or more petitions are pending in the same court by . . . a debtor and an affiliate, the court may order a joint administration of the estates." Fed. R. Bankr. P. 1015(b).

12. Joint administration is generally non-controversial, and courts in this district routinely order joint administration in multiple related cases. *See*, *e.g.*, Order, *In re LATAM Airlines Grp. S.A.*, Case No. 20-11254 (JLG) (Bankr. S.D.N.Y. May 27, 2020), ECF No. 34; Order, *In re Centric Brands Inc.*, Case No. 20-22637 (SHL) (Bankr. S.D.N.Y. May 20, 2020), ECF No.

54; Order, *In re Sears Holding Corp.*, Case No. 18-23538 (RDD) (Bankr. S.D.N.Y. Oct. 16, 2018), ECF No. 118.[2]

13. The relief requested herein is warranted. First, the Debtors are "affiliates," as that term is defined under section 101(2) of the Bankruptcy Code, and each Debtor's chapter 11 case is pending in this Court. Thus, the conditions set forth in Bankruptcy Rule 1015(b) for joint administration of the Chapter 11 Cases are satisfied. Second, the First Day Declarations support this Motion and establish that the joint administration of the Chapter 11 Cases is warranted and will ease the administrative burden for the Court and the parties in interest. As set forth in the First Day Declarations, the Debtors are affiliates, and their operations are largely interrelated or shared.

14. Moreover, many of the motions, hearings and orders that will arise in the Chapter 11 Cases will affect each and every Debtor. Joint administration of the Chapter 11 Cases will reduce parties' fees and costs by avoiding duplicative filings and objections and will make the most efficient use of the Court's valuable resources. Joint administration also will allow the Office of the United States Trustee for Region 2 (the "U.S. Trustee") and all parties in interest to monitor the Chapter 11 Cases with greater ease and efficiency. Finally, joint administration will not adversely affect the Debtors' respective constituencies because the relief requested herein is for procedural purposes only. No party in interest will be prejudiced by the joint administration of the Chapter 11 Cases. Rather, parties in interest will benefit from the cost reductions associated with the joint administration of the Chapter 11 Cases. Accordingly, the Debtors submit that the joint administration of the Chapter 11 Cases is in the best interests of their estates, their creditors and all other parties in interest.

[2] Because of the voluminous nature of the orders cited herein, such orders are not attached to this Motion. Copies of these orders are available upon request of the Debtors' proposed counsel.

NOTICE

15. Notice of the Motion will be given by facsimile, electronic transmission, hand delivery or overnight mail to: (i) the Office of the United States Trustee for Region 2; (ii) those creditors holding the fifty (50) largest unsecured claims against the Debtors' estates (on a consolidated basis); (iii) those creditors holding the five (5) largest secured claims against the Debtors' estates (on a consolidated basis); (iv) the Internal Revenue Service; (v) the Securities and Exchange Commission; and (vi) all others that are required to be noticed in accordance with Bankruptcy Rule 2002 and Local Rule 2002-1. The Debtors submit that, in light of the nature of the relief requested, no other or further notice need be given.

NO PRIOR REQUEST

16. No prior motion for the relief requested herein has been made to this or any other court.

[The remainder of this page is left intentionally blank]

CONCLUSION

WHEREFORE, for the reasons set forth herein, the Debtors respectfully request that this Court (a) enter an order, substantially in the form attached hereto as Exhibit A, and (b) grant such other and further relief as is just and proper.

Dated: January 20, 2023
New York, New York

/s/ Sean A. O'Neal

Sean A. O'Neal
Jane VanLare
CLEARY GOTTLIEB STEEN & HAMILTON LLP
One Liberty Plaza
New York, New York 10006
Telephone: (212) 225-2000
Facsimile: (212) 225-3999

Proposed Counsel to the Debtors and Debtors-in-Possession

EXHIBIT A

Proposed Order

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	:	Chapter 11
Genesis Global Holdco, LLC,	:	Case No. 23-10063
Debtor.	:	
Tax I.D. No. 38-4058219	:	
In re	:	Chapter 11
Genesis Global Capital, LLC,	:	Case No. 23-10064
Debtor.	:	
Tax I.D. No. 37-1878564	:	
In re	:	Chapter 11
Genesis Asia Pacific Pte. Ltd.	:	Case No. 23-10065
Debtor.	:	
Tax I.D. 202002164R (Singapore UEN)	:	

ORDER DIRECTING JOINT ADMINISTRATION OF RELATED CHAPTER 11 CASES

("JOINT ADMINISTRATION ORDER")

Upon the motion (the "Motion")[1] of Genesis Global Holdco, LLC ("Holdco") and its affiliates, as debtors and debtors-in-possession in the above-captioned cases (collectively, the "Debtors"), for entry of an order directing the joint administration of the Debtors' related chapter

[1] Capitalized terms used but not defined herein shall have the meanings ascribed to them in the Motion.

11 cases, as more fully described in the Motion; and upon the First Day Declarations, filed concurrently with the Motion; and the Court having jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the *Amended Standing Order of Reference* from the United States District Court for the Southern District of New York dated January 31, 2012; and the Court having found that this is a core proceeding pursuant to 28 U.S.C. § 157(b)(2), and that the Court may enter a final order consistent with Article III of the United States Constitution; and the Court having found that venue of this proceeding and the Motion in this district is proper pursuant to 28 U.S.C. §§ 1408 and 1409; and the Court having found that the relief requested in the Motion is in the best interests of the Debtors, their estates, their creditors and other parties in interest; and the Court having found that the Debtors' notice of the Motion and opportunity for a hearing on the Motion was appropriate and no other notice need be provided; and the Court having reviewed the Motion and having heard the statements in support of the relief requested therein at a hearing before the Court (the "Hearing"); and the Court having determined that the legal and factual bases set forth in the Motion and at the Hearing establish just cause for the relief granted herein; and upon all of the proceedings had before the Court; and after due deliberation and sufficient cause appearing therefor,

IT IS HEREBY ORDERED THAT:

1. The Motion is granted to the extent set forth herein.

2. The above-captioned Chapter 11 Cases are consolidated for procedural purposes only and shall be jointly administered by the Court under Case No. 23-10063.

3. The caption of the jointly administered cases shall read as follows:

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	Chapter 11
Genesis Global Holdco, LLC, *et al.*,[1]	Case No.: 23-10063
Debtors.	Jointly Administered

[1] The Debtors in these Chapter 11 Cases, along with the last four digits of each Debtor's tax identification number (as applicable), are: Genesis Global Holdco, LLC (8219); Genesis Global Capital, LLC (8564); Genesis Asia Pacific Pte. Ltd. (2164R). For the purpose of these Chapter 11 Cases, the service address for the Debtors is 250 Park Avenue South, 5th Floor, New York, NY 10003.

4. The foregoing caption satisfies the requirements set forth in section 342(c)(1) of the Bankruptcy Code.

5. A docket entry shall be made in each of the above-captioned cases substantially as follows: "An order has been entered in this case directing the procedural consolidation and joint administration of the Chapter 11 Cases commenced by Genesis Global Holdco, LLC. The docket in Case No. 23-10063 should be consulted for all matters affecting the above listed cases.

6. The Debtors shall maintain, and the Clerk of the United States Bankruptcy Court for the Southern District of New York shall keep, one consolidated docket, one file and one consolidated service list.

7. The Debtors shall file their monthly operating reports required by the *Operating Guidelines and Reporting Requirements for Debtors in Possession and Trustees*, issued by the U.S. Trustee, in accordance with the applicable Instructions for UST Form 11-MOR: Monthly Operating Report and Supporting Documentation.

8. Nothing contained in the Motion or this Order shall be deemed or construed as directing or otherwise effecting a substantive consolidation of the Chapter 11 Cases.

9. To the extent that any affiliates of the Debtors subsequently commence Chapter 11 cases, the relief granted pursuant to this Order shall apply to such debtors and their respective estates, provided, however, that the Debtors shall file notice with the Court identifying the cases of such affiliates and stating that this Order shall apply to such cases.

10. Notwithstanding any provision in the Federal Rules of Bankruptcy Procedure to the contrary, (i) the terms of this Order shall be immediately effective and enforceable upon its entry, (ii) the Debtors are not subject to any stay in the implementation, enforcement or realization of the relief granted in this Order, and (iii) the Debtors may, in their discretion and without further delay, take any action and perform any act authorized under this Order.

11. The Court shall retain jurisdiction with respect to all matters arising from or related to the implementation, interpretation, or enforcement of this Order.

Dated: _____ _____
New York, New York United States Bankruptcy Judge

TAB 24

In re Core Scientific Inc., et al., Case No. 22-90341 (Bankr. S.D.T.X.) Doc. No. 1

Fill in this information to identify the case:

United States Bankruptcy Court for the Southern District of Texas

Case number (*if known*): _____ Chapter 11

☐ Check if this is an amended filing

Official Form 201

Voluntary Petition for Non-Individuals Filing for Bankruptcy 06/22

If more space is needed, attach a separate sheet to this form. On the top of any additional pages, write the debtor's name and the case number (if known). For more information, a separate document, *Instructions for Bankruptcy Forms for Non-Individuals,* is available.

1. Debtor's name Core Scientific, Inc.

2. All other names debtor used in the last 8 years

Include any assumed names, trade names, and *doing business as* names

Power & Digital Infrastructure Acquisition Corp.
XPDI
Core Scientific Holding Co.

3. Debtor's federal Employer Identification Number (EIN) 86-1243837

4. Debtor's address

Principal place of business

210 Barton Springs Road
Number Street

Suite 300

Austin Texas 78704
City State ZIP Code

Travis
County

Mailing address, if different from principal place of business

2407 S. Congress Avenue
Number Street

Ste. E-101
P.O. Box

Austin Texas 78704
City State ZIP Code

Location of principal assets, if different from principal place of business

Number Street

City State ZIP Code

5. Debtor's website (URL) https://corescientific.com/

6. Type of debtor

☒ Corporation (including Limited Liability Company (LLC) and Limited Liability Partnership (LLP))
☐ Partnership (excluding LLP)
☐ Other. Specify: _____

Debtor Core Scientific, Inc. Case number (if known) 22-_____ ( )
Name

7. Describe debtor's business

A. *Check one:*

- ☐ Health Care Business (as defined in 11 U.S.C. § 101(27A))
- ☐ Single Asset Real Estate (as defined in 11 U.S.C. § 101(51B))
- ☐ Railroad (as defined in 11 U.S.C. § 101(44))
- ☐ Stockbroker (as defined in 11 U.S.C. § 101(53A))
- ☐ Commodity Broker (as defined in 11 U.S.C. § 101(6))
- ☐ Clearing Bank (as defined in 11 U.S.C. § 781(3))
- ☒ None of the above

B. *Check all that apply:*

- ☐ Tax- exempt entity (as described in 26 U.S.C. § 501)
- ☐ Investment company, including hedge fund or pooled investment vehicle (as defined in 15 U.S.C. § 80a-3)
- ☐ Investment advisor (as defined in 15 U.S.C. § 80b-2(a)(11))

C. NAICS (North American Industry Classification System) 4-digit code that best describes debtor. See http://www.uscourts.gov/four-digit-national-association-naics-codes.

5182 - Data Processing, Hosting, and Related Services

8. Under which chapter of the Bankruptcy Code is the debtor filing?

A debtor who is a "small business debtor" must check the first sub-box.
A debtor as defined in § 1182(1) who elects to proceed under subchapter V of chapter 11 (whether or not the debtor is a "small business debtor") must check the second sub-box.

Check one:

- ☐ Chapter 7
- ☐ Chapter 9
- ☒ Chapter 11. *Check all that apply*:
  - ☐ The debtor is a small business debtor as defined in 11 U.S.C. § 101(51D), and its aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than $3,024,725. If this sub-box is selected, attach the most recent balance sheet, statement of operations, cash-flow statement, and federal income tax return or if any of these documents do not exist, follow the procedure in 11 U.S.C. § 1116(1)(B).
  - ☐ The debtor is a debtor as defined in 11 U.S.C. § 1182(1), its aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than $7,500,000, **and it chooses to proceed under Subchapter V of Chapter 11**. If this sub-box is selected, attach the most recent balance sheet, statement of operations, cash-flow statement, and federal income tax return, or if any of these documents do not exist, follow the procedure in 11 U.S.C. § 1116(1)(B).
  - ☐ A plan is being filed with this petition.
  - ☐ Acceptances of the plan were solicited prepetition from one or more classes of creditors, in accordance with 11 U.S.C. § 1126(b).
  - ☒ The debtor is required to file periodic reports (for example, 10K and 10Q) with the Securities and Exchange Commission according to § 13 or 15(d) of the Securities Exchange Act of 1934. File the *Attachment to Voluntary Petition for Non-Individuals Filing for Bankruptcy under Chapter 11* (Official Form 201A) with this form.
  - ☐ The debtor is a shell company as defined in the Securities Exchange Act of 1934 Rule 12b-2.
- ☐ Chapter 12

9. Were prior bankruptcy cases filed by or against the debtor within the last 8 years?

If more than 2 cases, attach a separate list.

- ☒ No
- ☐ Yes District _____ When _____ (MM/ DD/ YYYY) Case number _____

District _____ When _____ (MM / DD/ YYYY) Case number _____

Debtor Core Scientific, Inc. Case number (if known) 22-____ ( )
Name

10. Are any bankruptcy cases pending or being filed by a business partner or an affiliate of the debtor?

List all cases. If more than 1, attach a separate list.

☐ No

☒ Yes

Debtor	See Schedule 1	Relationship	See Schedule 1
District	Southern District of Texas	When	December 21, 2022 MM / DD/ YYYY
Case number, if known			

11. Why is the case filed in this district?

Check all that apply:

☐ Debtor has had its domicile, principal place of business, or principal assets in this district for 180 days immediately preceding the date of this petition or for a longer part of such 180 days than in any other district.

☒ A bankruptcy case concerning debtor's affiliate, general partner, or partnership is pending in this district.

12. Does the debtor own or have possession of any real property or personal property that needs immediate attention?

☒ No

☐ Yes. Answer below for each property that needs immediate attention. Attach additional sheets if needed.

Why does the property need immediate attention? (*Check all that apply.*)

☐ It poses or is alleged to pose a threat of imminent and identifiable hazard to public health or safety.

What is the hazard? _____

☐ It needs to be physically secured or protected from the weather.

☐ It includes perishable goods or assets that could quickly deteriorate or lose value without attention (for example, livestock, seasonal goods, meat, dairy, produce, or securities-related assets or other options).

☐ Other _____

Where is the property?

Number Street

City State ZIP Code

Is the property insured?

☐ No

☐ Yes. Insurance agency _____

Contact Name _____

Phone _____

Statistical and administrative information

13. Debtor's estimation of available funds

Check one:

☒ Funds will be available for distribution to unsecured creditors.

☐ After any administrative expenses are paid, no funds will be available for distribution to unsecured creditors.

14. Estimated number of creditors

(on a consolidated basis with all affiliated debtors)

☐ 1-49	☒ 1,000-5,000	☐ 25,001-50,000
☐ 50-99	☐ 5,001-10,000	☐ 50,001-100,000
☐ 100-199	☐ 10,001-25,000	☐ More than 100,000
☐ 200-999		

Debtor Core Scientific, Inc. Case number (if known) 22-____ ( )
Name

15. Estimated assets (on a consolidated basis with all affiliated debtors)	☐ $0-$50,000	☐ $1,000,001-$10 million	☐ $500,000,001-$1 billion
	☐ $50,001-$100,000	☐ $10,000,001-$50 million	☒ $1,000,000,001-$10 billion
	☐ $100,001-$500,000	☐ $50,000,001-$100 million	☐ $10,000,000,001-$50 billion
	☐ $500,001-$1 million	☐ $100,000,001-$500 million	☐ More than $50 billion
16. Estimated liabilities (on a consolidated basis with all affiliated debtors)	☐ $0-$50,000	☐ $1,000,001-$10 million	☐ $500,000,001-$1 billion
	☐ $50,001-$100,000	☐ $10,000,001-$50 million	☒ $1,000,000,001-$10 billion
	☐ $100,001-$500,000	☐ $50,000,001-$100 million	☐ $10,000,000,001-$50 billion
	☐ $500,001-$1 million	☐ $100,000,001-$500 million	☐ More than $50 billion

Request for Relief, Declaration, and Signatures

WARNING – Bankruptcy fraud is a serious crime. Making a false statement in connection with a bankruptcy case can result in fines up to $500,000 or imprisonment for up to 20 years, or both. 18 U.S.C. §§ 152, 1341, 1519, and 3571.

17. Declaration and signature of authorized representative of debtor

- The debtor requests relief in accordance with the chapter of title 11, United States Code, specified in this petition.
- I have been authorized to file this petition on behalf of the debtor.
- I have examined the information in this petition and have a reasonable belief that the information is true and correct.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on December 21, 2022
MM / DD/ YYYY

✘ /s/ Todd DuChene
Signature of authorized representative of debtor

Todd DuChene
Printed name

President
Title

18. Signature of attorney

✘ /s/ Alfredo R. Pérez
Signature of attorney for debtor

Date December 21, 2022
MM / DD / YYYY

Alfredo R. Pérez	Ray C. Schrock, P.C.
Printed Name	
Weil, Gotshal & Manges LLP	Weil, Gotshal & Manges LLP
Firm Name	
700 Louisiana Street, Suite 1700	767 Fifth Avenue
Address	
Houston, Texas 77002	New York, New York 10153
City/State/Zip	
(713) 546-5000	(212) 310-8000
Contact Phone	
alfredo.perez@weil.com	Ray.Schrock@weil.com
Email Address	
15776275 Texas	
Bar Number State	

Official Form 201A (12/15)

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re	:	**Chapter 11**
CORE SCIENTIFIC, INC.,	:	**Case No. 22– _____ ( )**
Debtor.	:	

Attachment to Voluntary Petition for Non-Individuals Filing for Bankruptcy under Chapter 11

1. If any of the debtor's securities are registered under Section 12 of the Securities Exchange Act of 1934, the SEC file number is 001-40046.

2. The following financial data is the latest available information and refers to the debtor's condition on September 30, 2022.

a. Total assets $ 1,404,001,000

b. Total debts (including debts listed in 2.c., below) $ 1,330,974,000

c. Debt securities held by more than 500 holders N/A

				Approximate number of holder
☐ secured	☐ unsecured	☐ subordinated	$	
☐ secured	☐ unsecured	☐ subordinated	$	
☐ secured	☐ unsecured	☐ subordinated	$	
☐ secured	☐ unsecured	☐ subordinated	$	

d. Number of shares of preferred stock 0

e. Number of shares common stock 364,710,000

Comments, if any:

3. Brief description of debtor's business Core Scientific, Inc. operates facilities for digital asset mining and colocation services in North America. It provides blockchain infrastructure, software solutions, and services. The company mines digital assets for its own account and provides hosting colocation services for other large-scale miners.

4. List the names of any person who directly or indirectly owns, controls, or holds, with power to vote, 5% or more of the voting securities of debtor:

Darin Feinstein	8.21 %
MPM Life LLC	5.69 %
Michael Levitt	5.03 %

Schedule 1

Pending Bankruptcy Cases Filed by the Debtor and Affiliates of the Debtor

On the date hereof, each of the affiliated entities listed below, including the debtor in this chapter 11 case, filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code in the United States Bankruptcy Court for the Southern District of Texas (Houston Division) (the "**Court**"). A motion will be filed with the Court requesting that the chapter 11 cases of each Entity listed below be consolidated for procedural purposes only and jointly administered, pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy Procedure, under the case number assigned to the chapter 11 case of Core Scientific, Inc..

COMPANY
Core Scientific Mining LLC
Core Scientific, Inc.
Core Scientific Acquired Mining LLC
Core Scientific Operating Company
Radar Relay, Inc.
Core Scientific Specialty Mining (Oklahoma) LLC
American Property Acquisition, LLC
Starboard Capital LLC
RADAR LLC
American Property Acquisitions I, LLC
American Property Acquisitions VII, LLC

RESOLUTIONS OF
THE BOARD OF DIRECTORS
OF
CORE SCIENTIFIC, INC.

December 20, 2022

WHEREAS, the Board of Directors (the "***Board***") of **Core Scientific, Inc.**, a Delaware corporation (the "***Company***"), has, with the assistance of legal and financial advisors, been conducting a review of strategic alternatives;

WHEREAS, on November 14, 2022, the Board approved the formation of a special committee of directors (the "***Special Committee***"), and delegated certain responsibilities, powers and authority to, among other things, consider, analyze, evaluate, and oversee potential restructuring transactions and other strategic alternatives that may be available to the Company and its subsidiaries with respect to the Company's existing outstanding indebtedness and contractual and other liabilities;

WHEREAS, on December 12, 2022, the Board conveyed full decision-making authority to the Special Committee with respect to the evaluation, negotiations, and execution of any potential transaction;

WHEREAS, at a prior meeting on the date hereof, the Special Committee authorized and approved the actions set forth in these resolutions;

WHEREAS, the Board has reviewed and had the opportunity to ask questions about the materials presented by the management and the legal and financial advisors of the Company regarding the liabilities and liquidity of the Company, the strategic alternatives available to it and the impact of the foregoing on the Company's business;

WHEREAS, the Board has had the opportunity to consult with the management and the legal and financial advisors of the Company to fully consider each of the strategic alternatives available to the Company; and

WHEREAS, the Board believes that taking the actions set forth below are in the best interests of the Company and, therefore, desires to adopt, authorize, and approve the following resolutions**:**

I. Commencement of the Chapter 11 Case

NOW, THEREFORE BE IT RESOLVED, the Board has determined, after consultation with the management and the legal and financial advisors of the Company, that it is desirable and in the best interests of the Company, its creditors, and other parties in interest that a petition be filed by the Company seeking relief under the provisions of chapter 11 of title 11 of the United States Code (the "***Bankruptcy Code***") in the United States Bankruptcy Court for the Southern District of Texas (the "***Bankruptcy Court***"); and

RESOLVED, that any member, officer or director of the Company (each, an "***Authorized Officer***"), in each case, acting singly or jointly, be, and each hereby is, authorized, empowered, and directed, with full power of delegation, to negotiate, execute, verify, deliver and file, in the name and on behalf of the Company, and under its corporate seal or otherwise, all plans, petitions, schedules, statements, motions, lists, applications, pleadings, affidavits, declarations, orders, notices and other papers (collectively, the "***Chapter 11 Filings***") (with such changes therein and additions thereto as such Authorized Officer may deem necessary, appropriate or advisable, the execution and delivery of any of the Chapter 11 Filings by such Authorized Officer with any changes thereto to be conclusive evidence that such Authorized Officer deemed such changes to meet such standard) in the Bankruptcy Court, and, in connection therewith, to take

and perform any and all further acts and deeds which such Authorized Officer deems necessary, proper, or desirable in connection with the Company's chapter 11 case (the, "***Chapter 11 Case***"), including, without limitation, negotiating, executing, delivering, performing and filing any and all documents, schedules, statements, lists, papers, agreements, certificates, and/or instruments (or any amendments or modifications thereto) in connection with, or in furtherance of, the Chapter 11 Case and the transactions and professional retentions set forth in this resolution; and be it further

II. Retention of Advisors

RESOLVED, that, in connection with the Chapter 11 Case, any Authorized Officer, acting singly or jointly, be, and each hereby is, authorized, empowered and directed, with full power of delegation, in the name and on behalf of the Company, to employ and retain all assistance by legal counsel, accountants, financial advisors, investment bankers and other professionals, on behalf of the Company, that such Authorized Officer deems necessary, appropriate or advisable in connection with, or in furtherance of, the Chapter 11 Case, with a view to the successful prosecution of the Chapter 11 Case (such acts to be conclusive evidence that such Authorized Officer deemed the same to meet such standard); and be it further

RESOLVED, that the law firm of Weil, Gotshal & Manges LLP, located at 767 Fifth Avenue, New York, New York 10153, is hereby retained as attorneys for the Company in the Chapter 11 Case, subject to Bankruptcy Court approval; and be it further

RESOLVED, that the firm of PJT Partners LP, located at 280 Park Avenue, New York, New York 10017, is hereby retained as investment banker for the Company in the Chapter 11 Case, subject to Bankruptcy Court approval; and be it further

RESOLVED, that the firm of AlixPartners, LLP, located at 909 Third Avenue, New York, New York 10022, is hereby retained as financial advisor for the Company in the Chapter 11 Case, subject to Bankruptcy Court approval; and be it further

RESOLVED, that the firm of Stretto Inc., located at 7 Times Square, New York, New York 10036, is hereby retained as claims and noticing agent for the Company in the Chapter 11 Cases, subject to Bankruptcy Court approval; and be it further

III. Debtor-in-Possession Financing

RESOLVED, that in connection with the Chapter 11 Case, it is in the best interests of (i) in the case of the Company (the "***DIP Facility Borrower***"), to enter into and obtain loans, (ii) in the case of the Guarantors (as defined below), to guarantee the DIP Facility Borrower's obligations under the DIP Credit Agreement (as defined below), and (iii) in the case of the DIP Facility Borrower and the Guarantors, to consummate the transactions under that certain multiple draw superpriority senior secured debtor-in-possession term loan credit facility in an aggregate principal amount of up to $75,000,000 to be evidenced by that certain Secured Debtor-in-Possession Credit Agreement, by and among, the DIP Facility Borrower and each of the Company's subsidiary entities, as guarantors (the "***Guarantors***"), the lenders from time to time party thereto (the "***Lenders***"), and the administrative agent for the Lenders (in such capacity and together with its successors, the "***Agent***") (together with the Exhibits and Schedules annexed thereto, the "***DIP Credit Agreement***"; capitalized terms used in this section with respect to debtor-in-possession financing and not otherwise defined herein shall have the meanings ascribed to such terms in the DIP Credit Agreement) in each case subject to approval by the Bankruptcy Court, which is necessary and appropriate to the conduct of the business of the Company (the "***Debtor-in- Possession Financing***"); and be it further

RESOLVED, that the execution and delivery of the DIP Credit Agreement and the DIP Financing Documents (as defined below) by the Company and each of the Guarantors that is party thereto and the consummation by the Company of the transactions contemplated thereunder, including (i) in the case of the DIP Facility Borrower, the borrowing of funds under the DIP Credit Agreement, (ii) in the case of Guarantors, the guaranty of the obligations thereunder as provided in any guaranty, (iii) in the case of the DIP Facility Borrower and the Guarantors, the grant of a security interest in and liens upon substantially all of the Company's assets in favor of the secured parties (including the authorization of financing statements in connection with liens) and (iv) the execution, delivery and performance of all other agreements, instruments, documents, notices or certificates constituting exhibits to the DIP Credit Agreement or that may be required, necessary, appropriate, desirable or advisable to be executed or delivered pursuant to the DIP Credit Agreement or otherwise related thereto, including interest rate or currency hedging arrangements (each a "***DIP Financing Document***" and collectively, the "***DIP Financing Documents***"), the making of the representations and warranties and compliance with the covenants thereunder and the assumption of any obligations under and in respect of any of the foregoing, are hereby authorized and approved in all respects, and that any Authorized Officer, who may act without the joinder of any other Authorized Officer, is hereby severally authorized, empowered and directed, in the name and on behalf of the Company, to execute and deliver the DIP Credit Agreement and any other DIP Financing Document to which the Company is a party, with such changes therein and additions thereto as any such Authorized Officer, in his or her sole discretion, may deem necessary, convenient, appropriate, advisable or desirable, the execution and delivery of the Dip Credit Agreement and such DIP Financing Document with any changes thereto by the relevant Authorized Officer, to be conclusive evidence that such Authorized Officer deemed such changes to meet such standard; and be it further

RESOLVED, that the form, terms and provisions of each of (i) the DIP Credit Agreement, including the use of proceeds to provide liquidity for the Company throughout the Chapter 11 Case, substantially in the form presented to the Board and (ii) any and all of the other agreements, including, without limitation, any guarantee and security agreement, letters, notices, certificates, documents and instruments authorized, executed, delivered, reaffirmed, verified and/or filed in connection with the Debtor-in-Possession Financing and the performance of obligations thereunder, including the borrowings and guarantees contemplated thereunder, are hereby, in all respects confirmed, ratified and approved; and be it further

RESOLVED, that any Authorized Officer, acting singly or jointly, be, and each hereby is, authorized, empowered, and directed, in the name and on behalf of the Company, to cause the Company to negotiate and approve the terms, provisions of and performance of, and to prepare, execute and deliver the DIP Credit Agreement and any other DIP Financing Document, in the name and on behalf of the Company under its corporate seal or otherwise, and such other documents, agreements, instruments and certificates as may be required by the Agent or required by the DIP Credit Agreement and any other DIP Financing Documents; and be it further

RESOLVED, that the Company be, and hereby is, authorized to incur the obligations and to undertake any and all related transactions contemplated under the DIP Credit Agreement and any other DIP Financing Document including the granting of security thereunder; and be it further

RESOLVED, that any Authorized Officer, acting singly or jointly, be, and each hereby is, authorized, empowered, and directed, in the name and on behalf of the Company, to grant security interests in, and liens on, any and all property of the Company as collateral pursuant to the DIP Credit Agreement and any other DIP Financing Document to secure all of the obligations and liabilities of the Company thereunder to the Lenders and the Agent, and to authorize, execute, verify, file and/or deliver to the Agent, on behalf of the Company, all agreements, documents and instruments required by the Lenders in connection with the foregoing; and be it further

RESOLVED, that any Authorized Officer, acting singly or jointly, be, and each hereby is, authorized, empowered, and directed, in the name and on behalf of the Company, to take all such further actions including, without limitation, to pay all fees and expenses, in accordance with the terms of the DIP Credit Agreement and any other DIP Financing Document, which shall, in such Authorized Officer's sole judgment, be necessary, proper or advisable to perform the Company's obligations under or in connection with the DIP Credit Agreement or any other DIP Financing Document and the transactions contemplated therein and to carry out fully the intent of the foregoing resolutions; and be it further

RESOLVED, that any Authorized Officer, acting singly or jointly, be, and each hereby is, authorized, empowered, and directed, in the name and on behalf of the Company, to execute and deliver any amendments, supplements, modifications, renewals, replacements, consolidations, substitutions and extensions of the DIP Credit Agreement and/or any of the DIP Financing Documents which shall, in such Authorized Officer's sole judgment, be necessary, proper or advisable; and be it further]

IV. Restructuring Support Agreement

RESOLVED, that in connection with the Chapter 11 Case, the Board has determined that it is in the best interests of the Company to enter into a Restructuring Support Agreement (the "***Restructuring Support Agreement***") on the terms and conditions substantially similar to those set forth in the form of Restructuring Support Agreement previously provided to the Board; and be it further

RESOLVED, that the form, terms and provisions of the Restructuring Support Agreement, together with the term sheet annexed thereto (the "***Term Sheet***") and the execution, delivery and performance thereof and the consummation of the transactions contemplated thereunder by the Company are hereby authorized, approved and declared advisable and in the best interest of the Company, with such changes therein and additions thereto as the Authorized Officer executing the same may in his or her discretion deem necessary or appropriate, the execution of the Restructuring Support Agreement to be conclusive evidence of the approval thereof; and be it further

RESOLVED, that any Authorized Officer is hereby authorized, empowered, and directed, in the name and on behalf of the Company, to cause the Company to deliver, certify, file and/or record, the Restructuring Support Agreement, including the Term Sheet attached thereto and such other documents, agreements, instruments and certificates as may be required by the Restructuring Support Agreement, including the Term Sheet; and be it further

V. General Authority and Ratification

RESOLVED, that any Authorized Officer, acting singly or jointly, be, and each hereby is, authorized, empowered, and directed, with full power of delegation, in the name and on behalf of the Company, to take and perform any and all further acts or deeds that, in the judgment of such Authorized Officer, shall be or become necessary, proper, or desirable in connection with the Chapter 11 Case, including, but not limited to, (i) the negotiation of such additional agreements, amendments, modifications, supplements, reports, documents, instruments, motions, affidavits, applications for approvals or rulings of governmental or regulatory authorities, notes, certificates, or other documents that may be required, (ii) the execution, delivery, certification, recordation, performance under and filing (if applicable) of any of the foregoing, and (iii) the payment of all fees, consent payments, taxes and other expenses as any such Authorized Officer, in his or her sole discretion, may approve or deem necessary, appropriate or desirable in order to carry out the intent and accomplish the purposes of the foregoing resolutions and the transactions contemplated thereby, all of such actions, executions, deliveries, filings and payments to be conclusive evidence of such approval or that such Authorized Officer deemed the

same to meet such standard; and be it further

RESOLVED, that any and all past actions heretofore taken by any Authorized Officer in the name and on behalf of the Company in furtherance of any or all of the preceding resolutions be, and the same hereby are, ratified, confirmed, and approved in all respects as the acts and deeds of the Company.

Fill in this information to identify the case:

Debtor name: Core Scientific, Inc.

United States Bankruptcy Court for the Southern District of Texas (State)

Case number (*If known*): 22-_____ ( )

☐ Check if this is an amended filing

Official Form 204

Chapter 11 or Chapter 9 Cases: Consolidated List of Creditors Who Have the 30 Largest Unsecured Claims and Are Not Insiders 12/15

A list of consolidated creditors holding the 30 largest unsecured claims must be filed in a Chapter 11 or Chapter 9 case. Include claims which the debtor disputes.[1] Do not include claims by any person or entity who is an insider, as defined in 11 U.S.C. § 101(31). Also, do not include claims by secured creditors, unless the unsecured claim resulting from inadequate collateral value places the creditor among the holders of the 30 largest unsecured claims.

	Name of creditor and complete mailing address, including zip code	Name, telephone number, and email address of creditor contact	Nature of the claim (for example, trade debts, bank loans, professional services, and government contracts)	Indicate if claim is contingent, unliquidated, or disputed	Amount of unsecured claim If the claim is fully unsecured, fill in only unsecured claim amount. If claim is partially secured, fill in total claim amount and deduction for value of collateral or setoff to calculate unsecured claim.		
					Total claim, if partially secured	Deduction for value of collateral or setoff[2]	Unsecured claim
1	BRF Finance Co., LLC Attn.: General Counsel 30870 Russell Ranch Road, Suite 250 Westlake Village, California 91362	Attn.: General Counsel Phone: (310) 966-1444 Email: legal@brileyfin.com	Financing	Unliquidated			$42,364,611.00
2	Dalton Utilities Attn.: Tom Bundros 1200 V D Parrott Jr Parkway Dalton, Georgia 30721	Attn.: Tom Bundros Phone: (706) 278-1313 Facsimile: (706) 278-7230 Email: tbundros@dutil.com	Utility				$6,714,988.00
3	Shell Energy Solutions Attn.: Marty Lundstrom 21 Waterway Avenue, Suite 450 The Woodlands, Texas 77380	Attn.: Marty Lundstrom Phone: (832) 510-1042 Facsimile: (832) 510-1128 Email: marty.lundstrom@mp2energy.com	Utility				$3,808,132.00
4	U.S. Customs and Border Patrol Attn.: Raul Ortiz 1300 Pennsylvania Avenue, Suite 4.4-B Washington, District of Columbia 20229	Attn.: Raul Ortiz Phone: (202) 344-2050 Facsimile: (973) 368-6913	Customs Fees	Disputed			$3,375,019.00
5	Cooley LLP Attn.: Daniel Peale 1299 Pennsylvania Avenue, NW Suite 700 Washington, District of Columbia 20004	Attn.: Daniel Peale Phone: (202) 842-7835 Email: dpeale@cooley.com	Professional Services				$2,858,242.00
6	Kentucky Department of Revenue Attn.: Thomas B. Miller 501 High Street Frankfort, Kentucky 40601	Attn.: Thomas B. Miller Phone: (502) 564-5930 Facsimile: (502) 564-8946	Taxes	Disputed			$2,762,948.00

[1] This list does not include secured creditors that did not properly perfect their security interests and may, thus, be treated as unsecured creditors.

[2] The listing of a claim as partially secured shall not be deemed an admission by the Debtors as to the validity or enforceability of the security interest. The Debtors reserve all rights to challenge any amounts listed in this Top 30 creditor list.

Debtor Core Scientific, Inc. Case number (if known) 22-_____ ( )
Name

Name of creditor and complete mailing address, including zip code		Name, telephone number, and email address of creditor contact	Nature of the claim (for example, trade debts, bank loans, professional services, and government contracts)	Indicate if claim is contingent, unliquidated, or disputed	Amount of unsecured claim If the claim is fully unsecured, fill in only unsecured claim amount. If claim is partially secured, fill in total claim amount and deduction for value of collateral or setoff to calculate unsecured claim.		
					Total claim, if partially secured	Deduction for value of collateral or setoff[2]	Unsecured claim
7	Duke Energy Attn.: Tammy Daber, Power Contracts Administrator 9700 David Taylor Drive, Mail Code: DT01X Charlotte, North Carolina 28262	Attn.: Tammy Daber, Power Contracts Administrator Phone: (866) 541-8886 Email: tammy.daber@duke-energy.com	Utility				$2,113,213.00
8	Priority Power Management LLC Attn.: Robert L. Douglas 2201 E Lamar Boulevard, Suite 275 Arlington, Texas 76006	Attn.: Robert L. Douglas Phone: (408) 375-0865 Email: rdouglas@prioritypower.com	Construction	Unliquidated, Disputed	$24,000,000.00	$22,232,057.00	$1,767,943.00
9	Harper Construction Company, Inc. Attn.: Stephen Marble 2241 Kettner Boulevard, Suite 300 San Diego, California 92101	Attn.: Stephen Marble Phone: (619) 233-7900 Facsimile: (619) 233-1889 Email: lpz@harperconstruction.com	Construction	Disputed	$9,200,000.00	$7,500,000.00	$1,700,000.00
10	Trilogy LLC Attn.: Shamel Bersik 6255 Saddle Tree Drive Las Vegas, Nevada 89118	Attn.: Shamel Bersik Phone: (888) 514-4200 Email: Sam@trilogycorp.com	Equipment				$1,400,000.00
11	FlowTX Attn.: Lucas Leavitt 8610 Broadway Street, Suite 211 San Antonio, Texas 78217	Attn.: Lucas Leavitt Phone: (210) 455-0580 Email: lleavitt@flowtx.com	Construction				$1,200,00.00
12	Moss Adams LLP Attn.: Findley Gillespie 999 Third Avenue, Suite 2800 Seattle, Washington 98104	Attn.: Findley Gillespie Phone: (206) 302-6212 Email: findley.gillespie@mossadams.com	Professional Services				$456,434.00
13	Cherokee County Tax Collector Attn.: Delenna Stiles, Tax Collector 75 Peachtree Street, #225 Murphy, North Carolina 28906-2947	Attn.: Delenna Stiles, Tax Collector Phone: (828) 837-2421 Email: collections@cherokeecounty-nc.gov	Taxes				$413,737.00
14	AAF International Attn.: Stuart Nichols 9920 Corporate Campus Drive Suite 2200 Louisville, Kentucky 40223	Attn.: Stuart Nichols Phone: (803) 322-8796 Email: snichols@AAFintl.com	Trade Goods				$266,468.00
15	Sidley Austin LLP Attn.: Scott Parel 2021 McKinney Avenue, Suite 2000 Dallas, Texas 75201	Attn.: Scott Parel Phone: (214) 981-3431 Email: sparel@sidley.com	Professional Services				$231,085.00
16	Securitas Security Services USA Inc. Attn.: Patrick Melody 4330 Park Terrace Drive West Lake Village, California 91361	Attn.: Patrick Melody Phone: (763) 287-6618 Email: patrick.melody@securitasinc.com	Security Services				$195,373.00
17	CDW Direct Attn.: Rick Kulevich, General Counsel 200 N. Milwaukee Avenue Vernon Hills, Illinois 60061	Attn.: Rick Kulevich, General Counsel Phone: (847) 465-6000 Email: credit@cdw.com	Trade Goods				$175,420.00
18	CES Corporation Attn.: Scott Weatherall 28029-108 Avenue Acheson, AB T7X 6P7 Canada	Attn.: Scott Weatherall Phone: (780) 910-6037 Email: s.weatherall@cescorp.ca	Trade Goods	Contingent, Unliquidated			$174,951.00

Debtor Core Scientific, Inc. Case number (if known) 22-_____ ( )
Name

Name of creditor and complete mailing address, including zip code		Name, telephone number, and email address of creditor contact	Nature of the claim (for example, trade debts, bank loans, professional services, and government contracts)	Indicate if claim is contingent, unliquidated, or disputed	Amount of unsecured claim If the claim is fully unsecured, fill in only unsecured claim amount. If claim is partially secured, fill in total claim amount and deduction for value of collateral or setoff to calculate unsecured claim.		
					Total claim, if partially secured	Deduction for value of collateral or setoff[2]	Unsecured claim
19	Marshall County Sheriff Attn.: Trent Weaver, Sheriff 52 Judicial Drive Benton, Kentucky 42025	Attn.: Trent Weaver, Sheriff Phone: (270) 527-3112 Email: marshallso@marshallco.org	Taxes				$162,181.00
20	Tenet Solutions Attn.: Accounting Department 1238 Grey Fox Road Arden Hills, Minnesota 55112	Attn.: Accounting Department Phone: (651) 604-2838 Email: Tenet-AR@tenetsolutions.us	Trade Goods				$139,551.00
21	Tenaska Power Services Co Attn.: Drew Fossum 14302 FNB Parkway Omaha, Nebraska 68154	Attn.: Drew Fossum Phone: (817) 462-1521 Email: TPMCustomerService@tnsk.com	Utility				$113,951.00
22	Gensler Attn.: Todd Runkle 1011 S. Congress Avenue, Building 1, Suite 200 Austin, Texas 78704	Attn.: Todd Runkle Phone: (512) 867-8113 Email: todd_runkle@gensler.com	Construction				$104,110.00
23	OP Attn.: Elise Chittick 10030 Bent Oak Drive Houston, Texas 77040	Attn.: Elise Chittick Phone: (713) 595-0522 Email: echittick@ophouston.com	Trade Goods				$97,274.00
24	Bergstrom Electric Attn.: Steve Wasvick 3100 North Washington Street Grand Forks, North Dakota 58208	Attn.: Steve Wasvick Phone: (701) 775-8897 Email: Swasvick@berstromelectric.com	Construction				$89,929.00
25	Amazon Web Services Inc. Attn.: Rashmi Manchanda 410 Terry Avenue North Seattle, Washington 98109-5210	Attn.: Rashmi Manchanda Phone: (415) 539-5057 Email: rmmanch@amazon.com	Cloud Services				$76,120.00
26	McDermott Will and Emery LLP Attn.: Erin West 1 Vanderbilt Avenue New York, New York 10017	Attn.: Erin West Phone: (202) 756-8135 Email: eswest@mwe.com	Professional Services				$54,834.00
27	DK Construction Company Attn.: Justin Edwards, President 5165 Gilbertsville Highway Calvert City, Kentucky 42029-0388	Attn.: Justin Edwards, President Phone: (270) 395-7656 Facsimile: (270) 395-1975	Facility Maintenance				$40,561.00
28	Reed Wells Benson and Company Attn.: Kenneth Fulk 120010 N. Central Expressway, Suite 1100 Dallas, Texas 75243	Attn.: Kenneth Fulk Phone: (972) 788-4222 Email: kfulk@rwb.net	Construction				$34,400.00
29	LiveView Technologies Inc. Attn.: Chris Parker 1226 S 1480 W Orem, Utah 84058	Attn.: Chris Parker Phone: (801) 221-9408 Ext. 315 Email: chris.parker@lvt.com	Trade Goods				$25,877.00
30	Herc Rentals Attn.: Leslie Hunziker 27500 Riverview Center Boulevard Suite 100 Bonita Springs, Florida 34134	Attn.: Leslie Hunziker Phone: (239) 301-1675 Email: leslie.hunziker@hercrentals.com	Equipment Rental				$22,898.00

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re	:	**Chapter 11**
CORE SCIENTIFIC, INC.,	:	**Case No. 22– _____ ( )**
Debtor.	:	

CONSOLIDATED CORPORATE OWNERSHIP STATEMENT
PURSUANT TO FED. R. BANKR. P. 1007 AND 7007.1

Pursuant to Rules 1007(a)(1) and 7007.1 of the Federal Rules of Bankruptcy Procedure (the "**Bankruptcy Rules**"), attached hereto as **Exhibit A** is an organizational chart of Core Scientific, Inc. ("**Core Parent**") and its debtor affiliates (each, a "**Debtor**" and collectively, the "**Debtors**"). Pursuant to Rule 1007(a)(3) of the Bankruptcy Rules, the below organizational chart combined with this statement identify all holders having an equity interest in the above-captioned debtor in possession. The Debtors respectfully represent as follows:

Equity ownership of Core Parent is represented by ordinary shares, 8.21% held by Darin Feinstein, 5.69% held by Matthew Minnis through MPM Life LLC, 5.03% held by Michael Levitt, and 81.07% widely held by other shareholders in the aggregate.

As set forth on **Exhibit A**, Core Parent owns 100% of the outstanding equity interests of (i) Core Scientific Acquired Mining LLC ("**Core Mining**"), (ii) Core Scientific Mining LLC, and (iii) Core Scientific Operating Company ("**Core Operating**").

Core Mining owns 100% of the outstanding equity interests of Radar Relay, Inc. ("**Radar Relay**"). Radar Relay, in turn, owns 100% of the outstanding equity interests of RADAR LLC and Starboard Capital LLC.

Core Operating owns 100% of the outstanding equity interests of Core Scientific Specialty Mining (Oklahoma) LLC and American Property Acquisition LLC ("**American Property Acquisition**").

American Property Acquisition owns 100% of the outstanding equity interests of American Property Acquisitions I, LLC and American Property Acquisitions VII, LLC.

As noted on **Exhibit A**, Core Parent owns approximately 19% of the outstanding equity interest of Non-Debtor Core Scientific Partners, LP, which, is owned in part by, and owns equity interests in, various other non-Debtor affiliates of Core Parent (collectively, the "**Non-Debtor Affiliates**"). The Non-Debtor Affiliates were formed in connection with a potential transaction that was not consummated and are currently dormant.

Exhibit A

Organizational Chart

Debtor Status

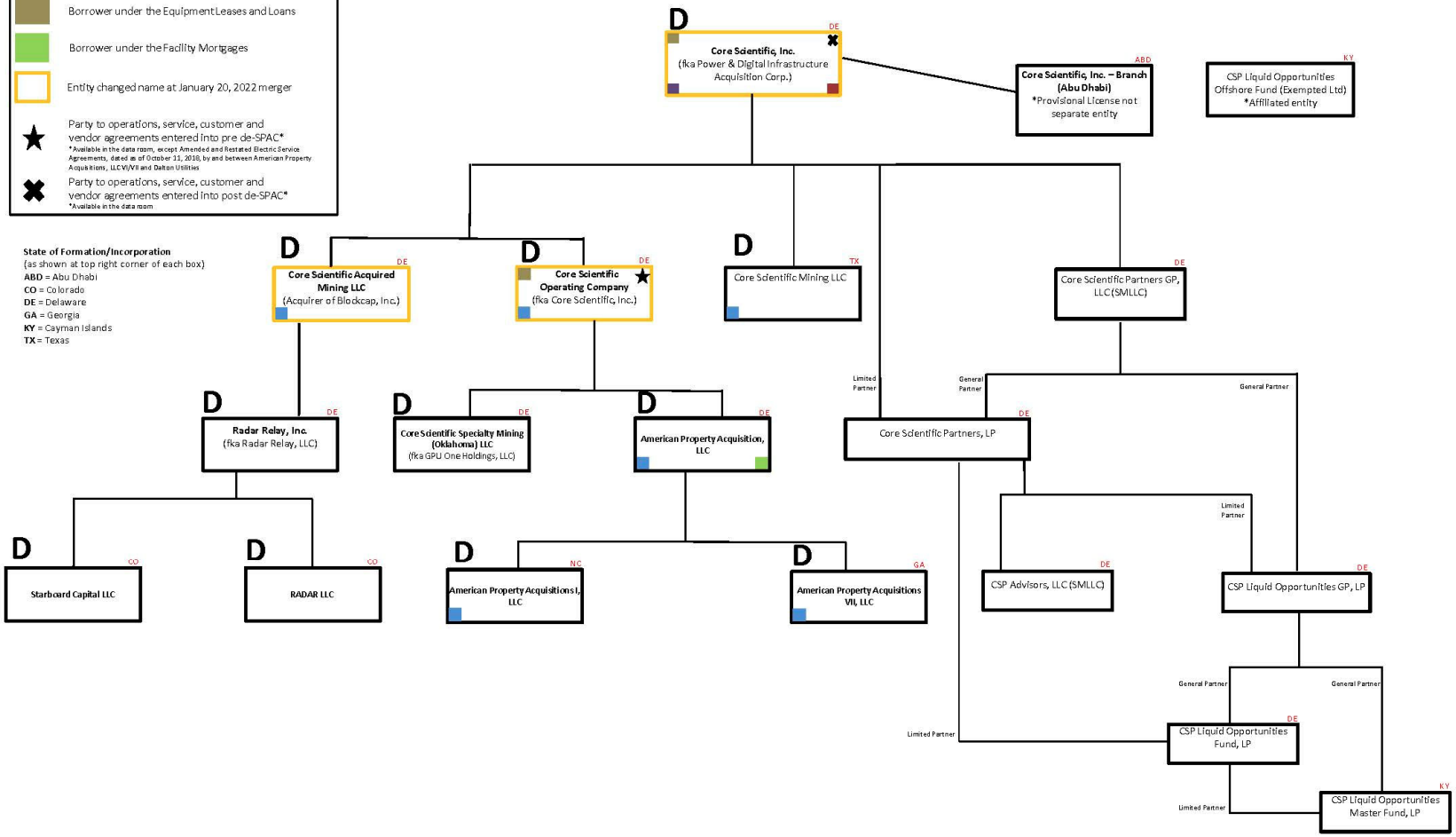
D = Debtor

CORE SCIENTIFIC®

Symbol Legend

- Borrower under the B. Riley Notes
- Issuer under the Convertible Notes
- Guarantor under the Convertible Notes
- Borrower under the Equipment Leases and Loans
- Borrower under the Facility Mortgages
- Entity changed name at January 20, 2022 merger
- ★ Party to operations, service, customer and vendor agreements entered into pre de-SPAC*
  *Available in the data room, except Amended and Restated Electric Service Agreements, dated as of October 11, 2018, by and between American Property Acquisitions, LLC VI/VII and Dalton Utilities
- ✖ Party to operations, service, customer and vendor agreements entered into post de-SPAC*
  *Available in the data room

State of Formation/Incorporation
(as shown at top right corner of each box)
ABD = Abu Dhabi
CO = Colorado
DE = Delaware
GA = Georgia
KY = Cayman Islands
TX = Texas



IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re	:	**Chapter 11**
CORE SCIENTIFIC, INC.,	:	**Case No. 22– _____ ( )**
Debtor.	:	

LIST OF EQUITY HOLDERS[1]

Pursuant to Rule 1007(a)(3) of the Federal Rules of Bankruptcy Procedure, the following identifies all holders having a direct or indirect ownership interest, of the above-captioned debtor in possession (the "**Debtor**").

Check applicable box:

☒ There are no equity security holders or corporations that directly or indirectly own 10% or more of any class of the Debtor's equity interest.

☒ The following are the Debtor's equity security holders (list holders of each class, showing the number and kind of interests registered in the name of each holder, and the last known address or place of business of each holder):

Name and Last Known Address or Place of Business of Holder	Kind/Class of Interest	Number of Interests Held
Darin Feinstein Address on File	Common Stock	8.21%

[1] This list reflects holders of five percent or more of the Core Parent's common stock, as of December 2 2022. The calculation is based on a total of 363,391,323 shares of common stock outstanding as of December 2, 2022. This list serves as the required disclosure by the Debtors pursuant to Rule 1007 of the Federal Rules of Bankruptcy Procedure. By separate motion, the Debtors will request a waiver of the requirement under Rule 1007 to file a list of all its equity holders.

Name and Last Known Address or Place of Business of Holder	Kind/Class of Interest	Number of Interests Held
MPM Life LLC Attn.: Matthew Minnis P.O. Box 22549 Houston, Texas 77227	Common Stock	5.69%
Michael J. Levitt Address on File	Common Stock	5.03%

Fill in this information to identify the case:

Debtor name: Core Scientific, Inc.

United States Bankruptcy Court for the Southern District of Texas (State)

Case number (*If known*): 22-_____ ( )

Official Form 202

Declaration Under Penalty of Perjury for Non-Individual Debtors 12/15

An individual who is authorized to act on behalf of a non-individual debtor, such as a corporation or partnership, must sign and submit this form for the schedules of assets and liabilities, any other document that requires a declaration that is not included in the document, and any amendments of those documents. This form must state the individual's position or relationship to the debtor, the identity of the document, and the date. Bankruptcy Rules 1008 and 9011.

WARNING – Bankruptcy fraud is a serious crime. Making a false statement, concealing property, or obtaining money or property by fraud in connection with a bankruptcy case can result in fines up to $500,000 or imprisonment for up to 20 years, or both. 18 U.S.C. §§ 152, 1341, 1519, and 3571.

Declaration and signature

I am the president, another officer, or an authorized agent of the corporation; a member or an authorized agent of the partnership; or another individual serving as a representative of the debtor in this case.

I have examined the information in the documents checked below and I have a reasonable belief that the information is true and correct:

- ☐ Schedule A/B: Assets–Real and Personal Property (Official Form 206A/B)
- ☐ Schedule D: Creditors Who Have Claims Secured by Property (Official Form 206D)
- ☐ Schedule E/F: Creditors Who Have Unsecured Claims (Official Form 206E/F)
- ☐ Schedule G: Executory Contracts and Unexpired Leases (Official Form 206G)
- ☐ Schedule H: Codebtors (Official Form 206H)
- ☐ Summary of Assets and Liabilities for Non-Individuals (Official Form 206Sum)
- ☐ Amended Schedule ____
- ☒ Chapter 11 or Chapter 9 Cases: List of Creditors Who Have the 30 Largest Unsecured Claims and Are Not Insiders (Official Form 204)
- ☒ Other document that requires a declaration Consolidated Corporate Ownership Statement and List of Equity Holders

I declare under penalty of perjury that the foregoing is true and correct.

Executed on December 21, 2022
MM /DD /YYYY

X /s/ Todd DuChene
Signature of individual signing on behalf of debtor

Todd DuChene
Printed name

President
Position or relationship to debtor

TAB 25

In re Squirrels Rsch. Labs, LLC, No. 21-61491, 2022 WL 1310173 (Bankr. N.D. Ohio Apr. 29, 2022)

2022 WL 1310173
Only the Westlaw citation is currently available.
(NOT FOR PUBLICATION)
United States Bankruptcy Court,
N.D. Ohio, Eastern Division.

IN RE: SQUIRRELS RESEARCH LABS, LLC, et al., Debtors.

CASE NO. 21-61491 (Jointly Administered)
|
Signed April 29, 2022

Attorneys and Law Firms

Brouse McDowell, Nicholas Paul Capotosto, Marc Merklin, Julie K. Zurn, Brouse McDowell LPA, Akron, OH, for Debtor Squirrels Research Labs LLC.

Frederic P. Schwieg, Rocky River, OH, Pro Se.

Kate M. Bradley ust44, Office of the U.S. Trustee, Cleveland, OH, for U.S. Trustee.

MEMORANDUM OF OPINION

Russ Kendig, United States Bankruptcy Judge

***1** On February 21, 2022, Carl Forsell ("Forsell") filed a Motion for Relief from the Sale Order for the Limited Purpose of Amending the Distribution Scheme Pending Discovery ("Motion"). Avnet, Inc. ("Avnet"), Debtors, and Instantiation LLC ("Instantiation") filed responses in opposition. The court held a telephonic hearing on April 12, 2022. The following parties participated in the hearing: Brian Sisto, counsel for Forsell; Christopher Combest, counsel for Avnet; Marc Merklin, attorney for Debtors; John Cannizzaro and Jeannie Kim, representing Instantiation; Kate Bradley on behalf of the United States Trustee; and Frederic Schwieg, the subchapter V trustee.

The court has subject matter jurisdiction of this case under 28 U.S.C. § 1334 and the general order of reference issued by the United States District Court for the Northern District of Ohio. General Order 2012-7. The court is authorized to enter final orders in this matter. Pursuant to 28 U.S.C. § 1409, venue in this court is proper.

BACKGROUND

The Parties

The debtors in this jointly administered case are Squirrels Research Labs LLC ("SQRL") and Midwest Data Company LLC ("Midwest"). SQRL "creates, manufactures, and repairs hardware, including Datacenter Accelerator Boards, used in cryptocurrency mining machines." (Decl. of David Stanfill ¶ 6, ECF No. 37.) Midwest "provides hosting services for cryptocurrency mining machines." (Id. at ¶ 7.) Debtors each filed a chapter 11 petition on November 23, 2021, electing to proceed under subchapter V of Chapter 11. (Pet., p. 2, ECF No. 1; Pet., p. 2, Case No. 21-61942, ECF No. 1.)

Forsell is a creditor of SQRL by virtue of several prepetition purchase orders for cryptocurrency mining equipment. (Proof of Claim 19-1.) He paid hundreds of thousands of dollars for the equipment and requested a refund upon notification that the boards were delayed. (Id.) He only received a small partial refund. (Id.) Forsell was included in the original creditor matrix through an attorney. (Pet., p. 18, ECF No. 1.) He filed a proof of claim for $744,373.60.

Avnet was Debtors' senior secured lender. In March 2019, SQRL borrowed $4,621,092.50 and executed a security agreement, granting Avnet a lien. (M. of Debtors for Int. and Final Orders Authorizing DIP Fin. ¶ 9, ECF No. 3.) In April 2021, the parties amended and restated their loan agreement, increasing the amount borrowed to $7,864,779.76, secured by the same lien. (Id. at ¶ 10.)

Instantiation provided postpetition financing and also purchased Debtors' assets. (Fin. Order Auth. Postpetition Financing, ECF No. 68; Order Auth. Sale of Certain of Debtors' Assets, ECF No. 131.)

Relevant History

Debtors entered into chapter 11 on November 23, 2021, with a prepackaged plan negotiated between Debtors, Avnet and Instantiation for the sale of Debtors' assets. They filed a motion to approve bid procedures and conduct an auction sale on the same date they filed their cases. ("Sale Motion") (Mot. for Order Establishing and Approving Bid Proc., ECF

No. 6.) As part of the sale process, Avnet agree to limit its $7,000,000.00+ claim to $5,751,000.00 and set the secured claim at $3,000.000.00. (Id. ¶ 11.) Instantiation offered to act as the stalking horse bidder, offering $3,010,000.00 for Debtors' assets. (Id., Exh. B.) On December 1, 2021, the court approved Debtors' plan to auction their assets. (Order Approving Bid Proc., ECF No. 40.) After Debtors failed to obtain any competing bids and cancelled the auction, the court approved the sale to Instantiation on January 18, 2022. ("Sale Order") (Order Auth. Sale of Certain of Debtors' Assets, ECF No. 131.) The sale was to close as soon as practicable. (Id.)

***2** In the first day motions, Debtors disclosed information concerning the initial note and the amended and restated note with Avnet. The papers reference execution of a security agreement "granting a lien in the collateral described therein." (M. Debtors for Int. and Fin. Orders Auth. The Midwest Data Co. LLC to Obt. DIP Financing ¶ 9-10, ECF No. 3.) Their schedules indicated Avnet held a "blanket" lien on "all physical assets" by virtue of a UCC financing statement. (Decl. under Penalty of Perjury, p. 29, ECF No. 62.)

Forsell was listed a as a creditor in the original creditor matrix. (Ch. 11 Subch. V Voluntary Petition, ECF No. 1.) When Debtors filed their schedules, Forsell was listed on Schedule E/F with a contingent, unliquidated, disputed claim for in an "unknown" amount for a "product refund." (Decl. Under Pen. of Perjury, ECF No. 62.) On November 23, 2021, Debtors served him, through his attorney, with copies of the Sale Motion and the corresponding motion to expedite the Sale Motion, on November 23, 2021. (Cert. of Serv., ECF No. 14.) They served him, again through his attorney, with the order granting the expedited process on November 24, 2021. Under that order, objections to the Sale Motion were due by November 30, 2021. Forsell did not file an objection to the Sale Motion. When the court approved the Sale Motion, the deadline to object to the "Sale Transaction" was set for January 10, 2022. Forsell was served with this order on December 2, 2021. (Cert. of Serv., ECF No. 57.) He did not object to the sale to Instantiation.

DISCUSSION

Approximately one month after the sale was approved, Forsell filed a motion for relief from the sale order. Forsell contends Avnet's lien was a purchase money security interest, not a blanket lien, and he wants discovery to determine if Avnet had an interest in collateral valued at $3,000,000.00. The court concludes he is not entitled to discovery related to the final sale order.

Parties have broad pretrial discovery rights in pursuit of claims and defenses and are authorized to obtain

> any nonprivileged matter that is relevant to any party's claim or defense and proportional to the needs of the case, considering the importance of the issues at stake in the action, the amount in controversy, the parties' relative access to relevant information, the parties' resources, the importance of the discovery in resolving the issues, and whether the burden or expense of the proposed discovery outweighs its likely benefit.

Fed. R. Bankr. Pro. 7026; Fed. R. Civ. Pro. 26(b)(1). The right to discovery after entry of a judgment is more obscure. H.K. Porter Co., Inc. v. The Goodyear Tire & Rubber Co., 536 F.2d 1115, 1118 (6th Cir. 1976) (recognizing "Goodyear has not cited, and we have not found, any cases dealing with the right to post-judgment discovery."). While Federal Rule of Civil Procedure 69(a)(2) grants discovery rights to judgment creditors, and their successors, "in aid of the judgment or execution, the rules provide no other authority and courts have struggled to find case law in support." Id., see also In re Wyatt, Inc., 168 B.R. 520, 523 (Bankr. D. Conn. 1994) (citations omitted) (stating "there is a dearth of cases discussing a party's right to post-trial or post-judgment discovery."); Pharmacy Records v. Nassar, 2010 WL 11545040, * 2 (E.D. Mich. 2010) (citing cases addressing post-judgment discovery). It has been suggested that when res judicata and collateral estoppel bar further litigation, discovery is also barred. In re Wilcher, 56 B.R. 428 (BAnkr. N.D. Ill. 1985); In re Silverman, 36 B.R. 254 (Bankr. S.D.N.Y. 1984).

***3** After noting the paucity of case law, the Sixth Circuit expressed its concern about the implications of permitting post-judgment discovery:

> A request for discovery for the purpose of attacking a final judgment involves considerations not present in pursuing discovery in a pending action prior to a judgment. Primary among these considerations is the public interest of the judiciary in protecting the finality of judgments.

H.K. Porter, 536 F.2d at 1118. Finality is particularly important in the context of chapter 11 sales. Without the comfort of finality, bidders and purchasers will be less inclined to offer maximum value for assets. In re Made in Detroit, 414 F.3d 576, 581 (6th Cir. 2005) (citations omitted). This is one reason a chapter 11 sale order receives statutory protection through 11 U.S.C. § 363(m). Any intent to disrupt a sale order must be carefully considered.

To balance the need for finality against a party's right to discovery, courts require the party seeking discovery to make a *prima facie* showing of an entitlement to relief. H.K. Porter, 536 F.2d at 1119 (stating "it is well within his discretion to require the moving party to make a showing in support of its allegations before requiring the prevailing party to submit a second time to extensive discovery."); Wyatt, 168 B.R. 520, 524 (finding "question thus becomes whether the noteholders have made a sufficient showing that they be allowed to obtain their requested discovery."). Forsell cited three grounds for relief from the sale order: (1) newly discovered evidence under 60(b)(2), (2) fraud, misrepresentation or misconduct on the court under 60(b)(3), and (3) another reason justifying relief under 60(b)(6). Movant must do more than suggest a right to relief to pursue discovery.

Forsell says he now understands that Avnet did not hold a blanket lien but held a purchase money security interest. He suggests that Avnet's interest in Debtors' assets may not have been secured for the stated $3,000,000.00. Rule 60(b)(2) requires Forsell to show (1) he exercised due diligence in obtaining the new information and (2) the evidence is material and would have led to a different outcome. Good v. Ohio Edison Co., 149 F.3d 413, 423 (6th Cir. 1998) (citations omitted). He has not made this showing.

First, there is nothing in the record to show Forsell was reasonably diligent in obtaining information about the nature of the lien. In fact, on the record in open court, he indicated he did not act because his claim was disputed. Movant made a strategic decision not to pursue the information prior to the sale. Second, the information was publicly available, as evidenced by the copy of the UCC financing statement he attached as an exhibit to his motion. The language in that financing statement directly recites the language in the security agreement, giving Avnet a lien on "all inventory, goods or other tangible assets, whether or not such assets are delivered to the Debtor, as well as all accounts, chattel paper, deposit accounts, accounts receivable, rights to payment of every kind, general intangibles, instruments, that arise from the sale of inventory and goods to the Debtor." (M. Relief from Sale Order, Exh. A, p. 1; Ex. B, p. 1, ECF No. 166.) A simple search would have at least put Forsell on notice of what type of lien existed. Third, there is no proof that this information is material and would alter the sale outcome. Forsell has not provided any proof of a misvaluation of the collateral that would lower the value of the secured claim.

***4** It's difficult to say "you don't have proof" while not giving Forsell the chance to look for it. But when the finality of the sale order is at issue, and Forsell sat on his hands during the sale process, the court is compelled to say it.

He reaches no more success under 60(b)(3). To succeed here, he must 'show that the adverse party committed a deliberate act that adversely impacted the fairness of the relevant legal proceding [in] question." Info-Hold, Inc. v. Sound Merchandising, Inc., 538 F.3d 448 (6th Cir. 2008) (quoting Jordan v. Paccar, Inc., No. 95-3478, 1996 WL 528950, *6 (6th Cir. Sept. 17, 1996) (unpublished)). The only "evidence" he references is Debtor's calling the lien a "blanket" lien rather than a purchase-money lien. Neither the Uniform Commercial Code nor the Bankruptcy Code define "blanket lien," leaving it open to interpretation.

Cases reveal that there is no unified understanding of what constitutes a "blanket" lien. Sometimes it may indicate a literal interest in all of the assets of a debtor. In re Nightlife Enterprises, L.P., 2010 WL 5264600 (Bankr. S.D.N.Y. 2010). Or it could apply to all of a certain type of assets, such as real estate interests. In re Quicksilver Resources Inc., 544 B.R. 781 (Bankr. D. Del. 2016). It also appears to reference something less than all of the assets of a debtor, referring to a comprehensive combination of assets. In re 3PL4PL, LLC,

619 B.R. 441 (Bankr. D. Col. 2020). One court described the unitary nature of an IRS lien, which covers real and personal property, as a blanket lien. In re Vargas Quinones, 581 B.R. 705, 714 (Bankr. D. P.R. 2017). In the context of mechanic's liens, other courts have used the term to apply to a lien covering all lots in a subdivision that benefitted from work on a single lot. In re Homesteads Community at Newtown, LLC, 526 B.R. 1, 11 (D. Conn. 2014); In re Old Town North, LLC, 519 B.R. 307 (Bankr. D. Col. 2014). Since there is no clear definition of what assets comprise a blanket lien, parties must exercise due diligence in determining the assets that serve as collateral.

The court is not convinced that Debtor's classification of the lien as a "blanket lien" was a misrepresentation. In this case, the schedules indicated the blanket lien was on "all physical assets." Not every item of collateral can be identified in the schedules because of the limited space. Describing a security interest in a broad array of assets as a "blanket" lien does not offend the court.

Forsell also raises 60(b)(6) as a basis for relief. This is a hard sell in any situation because it applies "only in exceptional or extraordinary circumstances which are not addressed by the first five numbered clauses of the Rule." Olle v. Henry & Wright Corp., 910 F.2d 357, 365 (6th Cir. 1990). The court finds nothing exceptional or extraordinary warranting relief. The court must re-emphasize that Forsell had notice of the sale motion and the truncated sale process. He did not seek discovery during that time period. The information that he now uses as a basis to attempt to alter the sale order was publicly available prior to the sale. He admits he took no action during the sale process because his claim was disputed. He did not object to the sale. He did not seek a stay of the sale order. Learning something that you wish you'd known sooner is not the exceptional or extraordinary circumstance intended to be covered by Rule 60(b)(6). Forsell has not made an elemental showing he is entitled to relief from the sale order. The court will therefore deny his request for post-judgment discovery.

CONCLUSION

***5** There is no clear right to post-judgment discovery. While it may be available, the principles of finality must be considered, and these principles are more consequential when a final chapter 11 sale order is at issue. The prospect of disrupting a final order requires the movant to make a prima facie showing that there is a basis for allowing the post-judgment discovery. Forsell failed to make this showing. The new evidence he references is not new, it was publicly available, and it could have been discovered prior to entry of the sale order. Debtors' use of the term "blanket lien" was not clearly erroneous. There is no indication Debtors used the term with deliberate intent to mislead others. Finally, the facts are not exceptional or extraordinary and therefore cannot provide a basis for relief.

The court will deny Forsell's Motion by separate order to be entered immediately.

All Citations

Slip Copy, 2022 WL 1310173

End of Document

TAB 26

In re Giga Watt, Inc., Case No. 18-03197 (Bankr. E.D. Wash.) WL 1587723

2021 WL 1587723
Only the Westlaw citation is currently available.
United States Bankruptcy Court, E.D. Washington.

IN RE: GIGA WATT, INC., a Washington corporation, Debtor.
Mark D. Waldron, as Chapter 7 Trustee, Plaintiff,
v.
Perkins Coie, LLP, a Washington limited liability partnership; Lowell Ness, an individual and California resident; Giga Watt Singapore, a Singapore corporation; and Andrey Kuzenny, a citizen of the Russian Federation; Defendants,
and
The Giga Watt Project, a partnership, Nominal Defendant.

Case No. 18-03197-FPC7
|
Adversary No. 20-80031
|
Signed April 22, 2021

Attorneys and Law Firms

Donald A. Boyd, Hummer Boyd PLLC, Yakima, WA, for Defendant Andrey Kuzenny.

Ralph E. Cromwell, Jr., Byrnes Keller Cromwell LLP, Seattle, WA, John D. Munding, Munding, P.S., Spokane, WA, for Defendant Perkins Coie LLP.

Pamela Marie Egan, Potomac Law Group PLLC, Seattle, WA, for Plaintiff.

ORDER GRANTING MOTION TO STRIKE JURY DEMAND

Frederick P. Corbit, Bankruptcy Judge

***1** The Giga Watt, Inc. bankruptcy case has a complicated history. This adversary proceeding was filed by the Chapter 7 Trustee of the bankruptcy estate of Giga Watt, Inc. and is based on the Trustee's allegations that the bankruptcy estate was harmed when the law firm of Perkins Coie, LLP, Lowell Ness, a partner at the law firm, and Andrey Kuzenny, the CEO of Giga Watt PTE. Ltd., breached fiduciary duties when they caused the premature release of funds that were held, pursuant to an unwritten escrow agreement, in the law firm's trust account.

On February 5, 2021, the Chapter 7 Trustee filed two motions: Motion to Strike Jury Demand (Adv. ECF No. 36) and Motion for Determination that Proceeding is Core (Adv. ECF No. 38). Perkins opposed both motions. (Adv. ECF Nos. 41, 42). Perkins also filed a Motion to Compel Arbitration and Stay the case (Adv. ECF No. 40), and the Trustee objected. (Adv. ECF No. 44) The Court addresses each motion in a separate opinion; this opinion grants the Trustee's Motion to Strike Jury Demand.

A. PROCEDURAL BACKGROUND

The Debtor, Giga Watt, Inc. ("Giga Watt") filed a petition for relief under Chapter 11 of the Bankruptcy Code (Title 11 U.S.C.) on November 19, 2018. Upon a motion from the Unsecured Creditors Committee, the Court appointed a Chapter 11 Trustee on January 18, 2019. (ECF No. 121) Twenty months later, on September 30, 2020, the Court granted the United States Trustee's motion to convert the main bankruptcy case to Chapter 7. (ECF No. 744)

On November 18, 2020, the Chapter 7 Trustee commenced this adversary proceeding. (Adv ECF No. 1) On November 19, 2020, the Trustee filed an Amended Verified Complaint against (i) Perkins Coie ("Perkins"), a law firm; (ii) Lowell Ness, [1] a partner in the Perkins firm; (iii) Giga Watt PTE, Ltd., ("Giga Watt Singapore") a Singapore corporation; and (iv) Andrey Kuzenny, a Russian Federation citizen who served as CEO of Giga Watt Singapore. (Adv. ECF No. 6) The Chapter 7 Trustee listed four causes of action, all related to allegations of breach of fiduciary duty, specifically: (1) Perkins breached a fiduciary duty to Giga Watt; (2) Giga Watt Singapore breached a fiduciary duty to Giga Watt; (3) Perkins aided and abetted Giga Watt Singapore's breach of fiduciary duty to Giga Watt; and (4) Andrey Kuzenny aided and abetted Giga Watt Singapore's breach of fiduciary duty to Giga Watt.

Perkins filed an answer and affirmative defenses, in which it admitted that it held proceeds from sales of digital tokens in an IOLTA, [2] and that it disbursed approximately $10.8 million to Giga Watt Singapore and approximately $10.8 million to the Debtor Giga Watt. (Adv. ECF No. 28 at 5) Perkins' affirmative defenses include a claim for offset, estoppel, *in pari delicto*, [3] account stated, failure to mitigate, and unclean hands.

***2** Andrey Kuzenny filed an answer in which he invoked "his privilege against self-incrimination as guaranteed by the Fifth Amendment" of the U.S. Constitution. (Adv. ECF No. 21) He raised several equitable affirmative defenses, including the doctrine of acquiescence, waiver, laches and estoppel. Mr. Kuzenny also argued that if found to act as alleged, his conduct was justified, excused and/or privileged.

On December 31, 2020, Perkins moved to withdraw the reference from the bankruptcy court. Perkins argued that cause exists under 28 U.S.C. § 157(d) to remove the case because: (1) the claims are not "core;" (2) the defendants do not consent to bankruptcy court jurisdiction, including entry of final orders or judgments, and a jury trial in bankruptcy court; and (3) a related class action is presently pending in District Court before the Honorable Stanley A. Bastian "that arises from the same facts and circumstances, asserts the same claims, and seeks the same damages from Defendants." (Adv. ECF No. 17)

Subsequently, the parties agreed to fully brief three issues—right to a jury, "core" versus "non-core," and arbitration—and to allow the Bankruptcy Court time to rule on the motions before transmitting the withdrawal of the reference motion to the District Court pursuant to 28 U.S.C. § 157(d), Federal Rules of Bankruptcy Procedure 5011 and Local Bankruptcy Rule 5011-1. (Adv. ECF Nos. 26, 35, 47 and 48)

B. FACTUAL BACKGROUND

The Giga Watt Project was a partnership between Giga Watt and Giga Watt Singapore to build and run a large-scale cryptocurrency mining operation, with investors who, after buying a "WTT Token,"[4] could install mining machines ("miners") in the building to generate cryptocurrency.

The Giga Watt entities published a "White Paper" for the purpose of presenting "the Giga Watt Project to potential token holders in connection with the proposed Token Launch." (Adv. ECF No. 6 Ex. A) Generally, the White Paper explained that Giga Watt would offer "mining hosting services" that consisted of buildings designed to house the miners along with the electrical power to run the machines, and Giga Watt Singapore would offer "turnkey mining services," such as selling miners and providing maintenance of the miners in the buildings. The project included an initial offering of WTT Tokens, similar to an initial public offering, called an Initial Coin Offering ("ICO") that was scheduled to begin August 7, 2017.

As part of the process of buying a WTT Token, each purchaser signed a Token Purchase Agreement that indicated it was an agreement with Giga Watt Singapore. The terms of the Token Purchase Agreement are disputed by the parties; the Trustee alleges that Perkins agreed to hold the funds from the ICO in escrow until Giga Watt met certain milestones in construction of the Giga Watt facilities.

Four days after the ICO closed, Perkins held over $22 million in token sale proceeds in an Interest on Lawyers Trust Account. Subsequent to the sale, Perkins made refunds to various token holders, and then made four disbursements to Giga Watt Singapore that totaled $10.8 million and four disbursements to Giga Watt that totaled a little over $10.8 million. By February 22, 2108, the escrow account was depleted.

***3** The Trustee's Amended Complaint includes allegations of a partnership agreement between Giga Watt and Giga Watt Singapore, and Giga Watt Singapore misappropriated $10.8 million of funds that Perkins was holding in escrow for the partnership. The Trustee, on behalf of Giga Watt, is suing its partner Giga Watt Singapore, Perkins and Andrey Kuzenny for violation of their respective fiduciary duties related to disbursement of the escrow funds.

The Trustee alleges that Perkins agreed to hold funds raised by the partnership in the ICO, pursuant to certain terms that were not reduced to a single formal document. The Trustee asserts that Perkins disregarded the parties' agreement about when the funds could be released, and the premature payouts guaranteed Giga Watt's collapse. The Trustee requests a judgment against defendants for joint and several liability in an amount to be proved at trial, plus prejudgment and post-judgment interest, costs and fees, and "for such other and further relief as the Court deems necessary and just." (Adv. ECF No. 11 at 31)

Perkins' answer generally denies liability and asserts legal and equitable affirmative defenses, including *in pari delicto*, equitable offset, equitable estoppel and unclean hands. Similarly, Andrew Kuzenny denied liability, and he, too, asserted equitable affirmative defenses, including the doctrine of acquiescence, waiver, laches and estoppel. Mr. Kuzenny also argues that if found to act as alleged, his conduct was justified, excused and/or privileged.

C. ANALYSIS

Generally, "the bankruptcy court is an appropriate tribunal for determining whether there is a right to a trial by jury of issues for which a jury trial is demanded." *In re Oakwood Homes Corp.*, 378 B.R. 59, 64 (Bankr. D. Del. 2007) (citing *Official Comm. Of Unsecured Creditors v. TSG Equity Fund L.P. (In re Envisionet Computer Servs.),* 276 B.R. 1, 6–7 (D. Me. 2002)). [5]

Additionally, a bankruptcy court is a court of equity in that it applies the principles and rules of equity. *Pepper v. Litton*, 308 U.S. 295, 304, 60 S. Ct. 238, 84 L.Ed. 281 (1939)(bankruptcy court exercises equitable jurisdiction to ensure that injustice or unfairness does not occur in the administration of a bankruptcy estate). Bankruptcy courts exercise these equitable powers that often extend to:

> a wide range of problems arising out of the administration of bankrupt estates. [These equitable powers] have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done.

Id. at 304-05. It is against this backdrop that the Court analyzes Perkins' Motion.

The Seventh Amendment grants the right of jury trial to "suits at common law," which the United States Supreme Court has interpreted to include only cases involving legal rights. *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 109 S. Ct. 2782, 106 L. Ed. 2d 26 (1989). "No jury right attaches to equitable claims." *Billing v. Ravin, Greenberg & Zackin*, 22 F.3d 1242, 1245 (3rd Cir. 1994). Whether a claim is accorded the right to jury trial under the Seventh Amendment depends on the nature of the issue to be tried, not the character of the overall action. *Chauffeurs, Teamsters and Helpers, Local No. 391 v. Terry*, 494 U.S. 558, 569, 110 S. Ct. 1339, 108 L. Ed. 2d 519 (1990).

***4** To determine whether a claim "is more similar to cases that were tried in courts of law than to suits tried in courts of equity or admiralty, the court must examine both the nature of the action and of the remedy sought." *Tull v. United States*, 481 U.S. 412, 417, 107 S. Ct. 1831, 95 L. Ed. 2d 365 (1987). *Granfinanciera* sets forth a three-part test to determine when a Seventh Amendment right to a jury trial exists:

> First, we compare the statutory action to 18th-century actions brought in the courts of England prior to the merger of the courts of law and equity. Second, we examine the remedy sought and determine whether it is legal or equitable in nature. The second stage of this analysis is more important than the first. If, on the balance, these two factors indicate that a party is entitled to a jury trial under the Seventh Amendment, we must decide whether Congress may assign and has assigned resolution of the relevant claim to a non-Article III adjudicative body that does not use a jury as factfinder.

Granfinanciera, 492 U.S. at 42 (citing *Tull v. United States*, 481 U.S. 412, 417–18, 421 (1987))(internal quotations and citations omitted); *accord Hale v. U.S. Trustee,* 509 F.3d 1139 (9th Cir. 2007)(*Granfinanciera* established a 3-part test to determine Seventh Amendment right to a jury trial.)

1. Nature of the claim.

Courts have struggled with the analysis required to determine the nature of a claim. Over thirty years ago, United States Supreme Court Justice Brennan articulated the difficulty as: "we have long acknowledged that, of the factors relevant to the jury trial right, comparison of the claim to ancient forms of action, 'requiring extensive and possibly abstruse historical inquiry, is obviously the most difficult to apply.' " *Terry,* 494 U.S. at 574 (Brennan, J., concurring in part and in judgment)(*quoting Ross v. Bernhard*, 396 U.S. 531, 538, n.10, 90 S. Ct. 733 (1970)).

In this case, the Trustee argues the claims in the Amended Complaint are equitable because Perkins held the funds in escrow, which is a trust. In 1791 England, disputes about trusts not involving land were equitable claims. Additionally, because the agreement was not reduced to writing, discovery is required, and in 1791, only a court of equity could order discovery. Finally, because the Amended Complaint involves claims of a partner against a partner, 1791 English law would have required a court of equity to resolve the dispute between the partners.

Perkins argues that the Trustee's claims are not equitable because an escrow relationship is based on contract, and breach of contract is a legal claim. Perkins also argues that even when an equitable claim is asserted, where the underlying conduct is actionable at law, the claim must be submitted to a jury. Perkins relies on *DePinto v. Provident Sec. Life Ins. Co.,* 323 F.2d 826, 837 (9th Cir. 1963) (breach of fiduciary duty was predicated upon gross negligence and therefore Seventh Amendment right to a jury existed).

When faced with analyzing the nature of the claim, United States Supreme Court Justice Stewart expressed doubt that issues are inherently legal or inherently equitable, and the Justice emphasized the importance of the context in which the claims arise: "[t]he fact is that there are, for the most part, no such things as inherently 'legal issues' or inherently 'equitable issues.' There are only factual issues, and, 'like chameleons [they] take their color from the surrounding circumstances.' " *Ross v. Bernhard*, 396 U.S. at 550 (Stewart, J. dissent)(defendants entitled to jury trial in shareholder derivative suit)(quoting James, Right to a Jury Trial in Civil Actions, 72 Yale L.J. 655 (1963)).

***5** Nevertheless, an action by a trust beneficiary against a trustee for breach of fiduciary duty was traditionally an action "within the exclusive jurisdiction of courts of equity." *Terry,* 494 U.S. at 567 (citing 2 J. Story, Commentaries on Equity Jurisprudence § 960, at 266 (13th ed. 1886); and Restatement (Second) of Trusts § 199(c)(1959)). [6]

In this case, Perkins argues that the Trustee's claims are legal, not equitable, because the claims arise out of an escrow relationship that is a contract. In essence, Perkins argues that a breach of a fiduciary duty claim is properly characterized as breach of contract claim. For support, Perkins relies heavily on *DePinto,* but this reliance is misplaced. *DePinto* was a shareholder derivative suit with a complex procedural history. On appeal, the Ninth Circuit found that because the trial court had "expressly found that none of the appellants was guilty of fraud, the conclusion seems inescapable that the finding that [director defendants] breached fiduciary duties owed ... actually rests upon a finding of gross negligence." *DePinto*, 323 F.2d at 837. The *DePinto* court concluded that "where a claim of breach of fiduciary duty is predicated upon underlying conduct, such as negligence, which is actionable in a direct suit at common law, the issue of whether there has been such a breach is ... a jury question." *Id.*

Perkins urges the Court to adopt an expansive view of *DePinto.* Under Perkins' argument, every breach of fiduciary duty claim could be "recast as an action at law such that parties seemingly would be entitled to a jury trial on any and all breach of fiduciary duty claims." *Pereira v. Cogan*, 2002 WL 989460, at *4 (S.D.N.Y. 2002)("breach of fiduciary duty has not historically been divided into its equitable and legal parts but treated as a single equitable cause of action"), *rev'd and remanded sub nom. Pereira v. Farace,* 413 F.3d 330 (2d Cir. 2005)(requested relief of legal damages outweighed equitable nature of claims). [7]

***6** This Court declines the invitation to recast the Trustee's breach of fiduciary duty claims as breach of contract claims. Instead, the Court recognizes that the Trustee's claims are for breach of fiduciary duty and aiding and abetting that breach, and the underlying facts and circumstances surrounding the claims have not yet been established. As a result, the Court must consider the Amended Complaint allegations at face value: the Trustee claims the defendants breached, or aided a breach, of a fiduciary duty, based on facts and circumstances yet to be proven, related to an agreement by certain Defendants to hold money in trust. In this case, the Trustee's claims asserted are equitable in nature.

2. Nature of Remedy Requested.

The second factor the court examines to determine whether a statutory action is more similar to cases that were tried in courts of law than to cases tried in courts of equity is the nature of the remedy requested. *Tull*, 481 U.S. at 417.

The Trustee argues that while the action resembles an action at law for damages, this make-whole relief was traditionally obtained in a court of equity, which had exclusive jurisdiction over trusts and trust estates. Equity courts could and did provide relief in the form of money damages. Perkins'

asserted defenses of setoff and recoupment are equitable, and the act of asserting these defenses waives any right to a jury trial.

Perkins argues that consistent with 18th century England, before a claim in equity could proceed the plaintiff had to show it lacked an adequate remedy at law. Here the remedy is money damages which is a legal remedy. Perkins argues that even where both equitable and legal relief is requested, defendants retain a right to jury trial under *Dairy Queen v. Wood,* 369 U.S. 469, 82 S. Ct. 894, 8 L. Ed. 2d 44 (1962).

Prior to the adoption of the Rules of Civil Procedure, and for years after, it was generally held that if a claim was equitable in character, no right to a jury trial existed on an issue of damages incidental to the equitable relief that the plaintiff sought. *See* 5 Federal Practice P 38.19(2) at 169 (1977); *Camp v. Boyd*, 229 U.S. 530, 552, 33 S.Ct. 785, 57 L.Ed. 1317 (1913)(equitable court has authority to resolve legal claims that are presented in equitable matter). Moreover, courts of equity have the authority to award monetary remedies:

> while injunctions were the exclusive business of equity, it was never true that money claims were totally excluded from its jurisdiction. Actions against a trustee for breach of trust ... are a classic example of the power of an equity judge to require a defendant to pay money.

Sec. & *Exch. Comm'n v. Commonwealth Chem. Sec., Inc.*, 574 F.2d 90, 95 (2d Cir. 1978)(internal citations omitted); *see also* *Bessette v. Avco Financial Services, Inc.*, 230 F.3d 439, 446 (1st Cir. 2000)(holding that a bankruptcy court, as court of equity, may award money damages to give complete remedial relief for contempt); *contra*, *Pereira,* 413 F.3d at 340 (finding a right to a jury trial in breach of fiduciary case because requested relief was not restitution but "compensatory damages – a legal claim.").

Perkins argues that *Dairy Queen* dictates that Defendants have a right to a jury trial. The Court disagrees. The *Dairy Queen* court held that where the plaintiff alleged breach of contract, a legal claim, the defendants' equitable counterclaims did not defeat the right to a jury trial. The *Dairy Queen* opinion emphasized that the plaintiff requested damages for the contract breach: "we think it plain that their claim for a money judgment is a claim wholly legal in its nature...." *Id.* at 477. In determining a right to a jury trial existed, the *Dairy Queen* court concluded, "[a]s an action on a debt allegedly due *under a contract*, it would be difficult to conceive of an action of a more traditionally legal character." *Id.* (emphasis added).

***7** In this case, unlike *Dairy Queen,* the Court is not presented with a legal claim and an equitable counterclaim. Instead, this Court is presented with equitable claims and equitable affirmative defenses. The Trustee's claims are not based upon a contract breach, but instead on breach of fiduciary duty. Here, unlike the *Dairy Queen* claims, the Trustee's claims are based upon an apparently unwritten trust agreement and the Defendants are alleged to have breached, aided and abetted a fiduciary duty related to keeping the funds in trust. Simply put, *Dairy Queen* does not apply.

The Court recognizes that the Trustee's Amended Complaint requests monetary damages, but monetary damages are not always characterized as legal relief. In *Terry,* the Supreme Court ruled that where damages sought were incidental to or intertwined with equitable relief, the damages should be characterized as equitable. *Terry,* 494 U.S. at 571 n. 8; *see also* *Elegant Equine, Inc.*, 155 B.R. at 192. Moreover, "[i]t is the historic purpose of equity to secure complete justice. The courts will be alert to adjust their remedies so as to grant the necessary relief." *United States v. Martinson*, 809 F.2d 1364, 1367–68 (9th Cir. 1987); *see* *EEOC v. General Telephone Co.*, 599 F.2d 322, 334 (9th Cir. 1979), aff'd 446 U.S. 318, 100 S.Ct. 1698, 64 L.Ed.2d 319 (1980). Courts of equity "must 'look to the practical realities ... involved in reconciling competing interests' in determining the "special blend of what is necessary, what is fair, and what is workable." *Int'l Bhd. of Teamsters v. United States*, 431 U.S. 324, 375, 97 S. Ct. 1843, 1875, 52 L. Ed. 2d 396 (1977)(quoting *Lemon v. Kurtzman*, 411 U.S. 192, 200-201, 93 S.Ct. 1463, 1469, 36 L.Ed.2d 151 (1973)).

Additionally, the single fact that the Trustee requested monetary damages is not enough to require a jury trial. The Trustee requests a judgment against Defendants for joint and several liability in an amount to be proven at trial,

plus prejudgment and post-judgment interest, costs and fees, and "for such other and further relief as the Court deems necessary and just." (Adv. ECF No. 11 at 31) While the *Granfinanciera* test requires the court to weigh this factor more heavily than the nature of the issue, this factor is not considered in isolation, above all else. Indeed, the *Terry* court declined Justice Brennan's invitation to eliminate the three-part test and instead, decided the issue solely on the form of relief requested. *See* *Terry*, 494 U.S. at 575 (Brennan, J. concurring in the result). [8]

It is significant to the Court's analysis that Perkins and Kuzenny requested equitable relief in the form of multiple equitable affirmative defenses. In order to determine if the equitable affirmative defenses reduce or eliminate liability, the court must apply the principles and rules of equity. For example, Perkins alleges they are entitled to an equitable "offset" on the basis that if Giga Watt Singapore wrongly instructed Perkins to disburse funds, then as its partner, Giga Watt is liable to Perkins for damages incurred. *See* *In re County of Orange*, 183 B.R. 609, 622–23 (Bankr. C.D. Cal. 1995)(offset is an equitable remedy which rests in the discretion of the court). Also, Perkins asserts that Plaintiff is barred from recovery under the equitable doctrine of *in pari delicto*. *See* *Memorex Corp. v. Int'l Bus. Machines Corp.*, 555 F.2d 1379, 1381 (9th Cir. 1977)(*in pari delicto* is traditional equitable defense). Additionally, Perkins asserts that Plaintiff's claims are barred in whole or part under the equitable doctrine of equitable estoppel because Plaintiff knew about the progress of construction and yet chose to keep the wrongly distributed funds. *See* *Jablon v. United States*, 657 F.2d 1064, 1068 (9th Cir. 1981)("equitable estoppel is used to bar a party from raising a defense or objection it otherwise would have"). Finally, Perkins and Kuzenny allege the Plaintiff acted inequitably and should be barred from seeking or obtaining any equitable remedies under the equitable doctrine of unclean hands. *See,* *Precision Instrument Mfg. Co. v. Auto. Maint. Mach. Co.*, 324 U.S. 806, 814, 65 S. Ct. 993, 89 L. Ed. 1381 (1945)(under the clean hands doctrine, court of equity has wide discretion in refusing to aid the litigant tainted with "inequitableness or bad faith").

***8** In this case, Perkins urges the Court to characterize the relief requested by Plaintiff as purely legal damages, and on that basis conclude Defendants are entitled to a jury trial. This Court does not take such a narrow view of the Amended Complaint. The Amended Complaint requests money damages, but before arriving at a remedy, the Court must apply equitable principles. For example, before finding liability, the Court must determine if an escrow or trust relationship existed, the terms of the agreement and relationship, the agreement or understanding about when the funds could be released and to whom, and whether several equitable affirmative defenses limit or eliminate liability. While not explicitly set forth in the Amended Complaint, it is axiomatic that prior to determining a remedy, the Court must apply equitable rules and principles to determine whether a fiduciary duty existed and was breached and whether equitable principles reduce or eliminate Defendants' liability.

Sound reasons exist for authorizing a court of equity to award monetary damages. "A court of equity ought to do justice completely, and not by halves." *Camp,* 229 U.S. at 551. "One of the duties of such a court is to prevent a multiplicity of suits, and to this end a court of equity, if obliged to take cognizance of a cause for any purpose, will ordinarily retain it for all purposes, even though this requires it to determine purely legal rights that otherwise would not be within the range of its authority." *Id.*

Moreover, bankruptcy courts, as courts of equity, have broad powers to afford complete relief. *See Pepper, supra.* Also, "[i]n the exercise of its equitable jurisdiction, the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankruptcy estate." *Id.* The bankruptcy court's equitable powers are particularly important where, as is alleged in this case, the dispute involves an insolvent entity and damage done by fiduciaries at the expense of creditors. *See id.; see also Sawyer v. Hoag,* 84 U.S. 610, 622, 21 L. Ed. 731 (1873).

In sum, the Trustee's claims sound in equity. The Court must apply equitable principles to determine if fiduciary duties existed and were breached, and if Defendants' asserted equitable affirmative defenses are supported and thereby reduce or eliminate Defendant's liability. While Plaintiff requested monetary damages that single factor does not require a jury trial. Balancing the above described factors, as required under *Granfinanciera,* this Court concludes that no Seventh Amendment right to a jury trial exists in this case.

The Trustee's Motion to Strike Jury Demand (Adv. ECF No. 36) is **GRANTED.**

So Ordered.

All Citations

Not Reported in B.R. Rptr., 2021 WL 1587723

Footnotes

1 "Perkins" will refer to Perkins Coie and Mr. Ness for brevity and will be used as if singular.

2 "IOLTA" is an acronym for Interest On Lawyer Trust Accounts.

3 *In pari delicto* is an equitable common-law defense that derives from the Latin, *in pari delicto potior est conditio defendentis*: "In a case of equal or mutual fault ... the position of the [defending] party ... is the better one." *Bateman Eichler, Hill Richards, Inc. v. Berner,* 472 U.S. 299, 306, 105 S. Ct. 2622, 2626, 86 L. Ed. 2d 215 (1985).

4 The Giga Watt entities defined a WTT Token as: "an Ethereum token representing the right to use the Giga Watt processing center's capacity, rent-free for 50 years, to accommodate 1 Watt's worth of mining equipment power consumption." (Adv. ECF No. 6 at Ex. A)

5 Also, in this case the parties agreed to submit this issue to the Bankruptcy Court for determination. (See Adv. ECF Nos. 26, 35)

6 *See also* Austin W. Scott & William F. Fratcher, THE LAW OF TRUSTS § 197, at 188 (4th ed. 1988)("Trusts are, and have been since they were first enforced, within the peculiar province of courts of equity."); *In re Hutchinson*, 5 F.3d 750, 757 (4th Cir. 1993)("The basis for holding bankruptcy trustees liable is the equitable power of courts to enforce fiduciary duties."); *In re Jensen*, 946 F.2d 369, 371 (5th Cir. 1991)("Claims for breach of fiduciary duty have always been within the exclusive jurisdiction of the courts of equity."); *In re Evangelist,* 760 F.2d 27, 29 (1st Cir. 1985)("Actions for breach of fiduciary duty, historically speaking, are almost uniformly actions 'in equity,' carrying with them no right to trial by jury."); *In re Elegant Equine*, 155 B.R. 189, 192-93 (Bkrtcy. N.D. Ill. 1993)("Historically, breach of fiduciary duty actions have been considered to be equitable."); *In re Sunshine Trading & Transportation Company,* 193 B.R. 752 (Bkrtcy. E.D. Va. 1995)(no right to jury trial where adversary suit sought to hold bankruptcy trustee liable for acts derivative of his fiduciary duties); *cf. In re Combined Metals Reduction Company,* 557 F.2d 179, 197 (9th Cir. 1977)("when a trustee has breached his trust, an equity court may hold him liable for any loss ..."); *contra, Anderson v. United States*, 520 F.2d 1027 (5th Cir. 1975) (stating in dictum that action against bankruptcy trustee for negligent failure to obtain discharge of corporate liability was an action at law).

7 In a pointed dissent, Supreme Court Justice Stewart offer sharp criticism of *DePinto* in a similar case, *Ross v. Bernhard*, 396 U.S. at 546 (Stewart, J., dissent). Justice Stewart disagreed with the majority's conclusion that the *Ross* defendants had a right to a jury in a breach of fiduciary duty claim on the basis that the underlying action included breach of contract and negligence. Justice Stewart noted that a breach of fiduciary duty claim "has in practice always been treated as a single cause tried exclusively in equity. This has been not simply the "general" or "prevailing" view in the federal courts ... but the unanimous view with the single exception of

the Ninth Circuit's 1963 decision in *DePinto v. Provident Security Life Ins. Co.*, 323 F.2d 826, a decision that has since been followed by no court until the present case." *Id.*

8 "Since the existence of a right to jury trial therefore turns on the nature of the remedy, absent congressional delegation to a specialized decisionmaker, there remains little purpose to our rattling through dusty attics of ancient writs. The time has come to borrow William of Occam's razor and sever this portion of our analysis." *See* *Terry*, 494 U.S. at 575 (Brennan, J. concurring in the result).

TAB 27

In re Hao, 644 B.R. 339 (Bankr. E.D. Va. 2022)

644 B.R. 339
United States Bankruptcy Court, E.D. Virginia, Alexandria Division.

IN RE: Bin HAO, Debtor.

Case No. 22-10478-BFK
|
Signed September 7, 2022

Synopsis

Background: United States Trustee (UST) filed motion to convert or dismiss debtor's case under Subchapter V of Chapter 11.

Holdings: The Bankruptcy Court, Brian F. Kenney, J., held that:

[1] debtor's bad faith conduct warranted conversion or dismissal;

[2] continuing loss to, or diminution of, the bankruptcy estate supported conversion or dismissal;

[3] debtor's amended plan could not be confirmed on feasibility grounds, demonstrating the absence of a reasonable likelihood of rehabilitation that supported conversion or dismissal;

[4] debtor's amended plan could not be confirmed on good faith grounds, demonstrating the absence of a reasonable likelihood of rehabilitation that supported conversion or dismissal; and

[5] conversion to Chapter 7 for "cause," rather than dismissal of debtor's case, was in the best interests of the creditors.

Motion granted.

Procedural Posture(s): Motion to Convert or Dismiss Case.

West Headnotes (8)

[1] Bankruptcy Good Faith; Motive

Every bankruptcy case carries with it an obligation of good faith. 11 U.S.C.A. § 1129(a)(3).

[2] Bankruptcy "Bad faith."

Debtor's bad faith conduct warranted conversion or dismissal of case under Subchapter V of Chapter 11 for "cause," where debtor did not accurately and timely disclose all of his assets and was on his fourth set of schedules, each amendment being prompted by inquiries from the United States Trustee (UST) or the Subchapter V trustee, and debtor had acknowledged that he needed to amend his schedules again to disclose, inter alia, cryptocurrency accounts, and debtor had stated "none" when asked about transfers to family members when, in fact, he transferred funds to his cousin on two occasions, and debtor's testimony that he understood the term transfers of "property" to be limited to transfers of real property was not credible because debtor was highly financially sophisticated, and debtor had failed to pay post-petition domestic support obligations. 11 U.S.C.A. § 1129(a)(3).

[3] Bankruptcy Loss to or diminution of estate and unlikelihood of rehabilitation

Continuing loss to, or diminution of, the bankruptcy estate supported conversion or dismissal of case under Subchapter V of Chapter 11 for "cause," where debtor was accruing legal fees and Subchapter V trustee fees, but his monthly operating reports indicated he had no income and no ability to pay. 11 U.S.C.A. § 1112(b)(4)(A).

[4] Bankruptcy Want or inadequacy of plan

Debtor's amended plan in case under Subchapter V of Chapter 11 could not be confirmed on feasibility grounds, demonstrating the absence of a reasonable likelihood of rehabilitation that supported conversion or dismissal of case for "cause," because debtor would not have the

income with which to make plan payments; according to monthly operating reports, debtor had approximately $2,000 in monthly disposable income with which to make the plan payments, but plan payments were between $1,970.59 per month $3,574.13 per month and increased steadily up to $3,574.13 per month. 11 U.S.C.A. §§ 1112(b)(4)(A), 1129(a)(11), 1181(a), 1191(c)(3).

[5] **Bankruptcy** Want or inadequacy of plan

Debtor's amended plan in case under Subchapter V of Chapter 11 could not be confirmed on good faith grounds, demonstrating the absence of a reasonable likelihood of rehabilitation that supported conversion or dismissal of case for "cause," as debtor proposed to make a distribution to his unsecured creditors of one and a half cents on the dollar over a five-year period, which was a meaningless distribution, and debtor's amended plan was a liquidating plan, but his domestic support obligations and tax debt were both nondischargeable and would be nondischargeable under Chapter 7 as well. 11 U.S.C.A. §§ 1112(b)(4)(A), 1129(a)(3), 1181(a), 1191(a).

[6] **Bankruptcy** Good faith and legality

Prospect of a meaningful distribution is one factor to be considered in deciding whether Chapter 11 case has been proposed in good faith. 11 U.S.C.A. § 1129(a)(3).

[7] **Bankruptcy** In General; Grounds in General

Conversion to Chapter 7 for "cause," rather than dismissal of debtor's case under Subchapter V of Chapter 11, was in the best interests of the creditors, as dismissal without prejudice would only invite debtor to file the same case a second time and there would be no resolution of creditors' claims outside of bankruptcy, whereas Chapter 7 trustee could evaluate the claims objectively and pursue them if they were available for the benefit of the creditors. 11 U.S.C.A. § 1112(b)(1).

[8] **Bankruptcy** In General; Grounds in General

When bankruptcy court finds that there is cause to convert or dismiss Chapter 11 case, it must determine whether conversion or dismissal is in best interests of creditors. 11 U.S.C.A. § 1112(b)(1).

Attorneys and Law Firms

***340** Bin Hao, 13008 Cabin Creek Rd., Herndon, VA 20171, Subchapter V Debtor.

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FINDINGS OF FACT AND CONCLUSIONS OF LAW

Brian F. Kenney, United States Bankruptcy Judge

***341** This matter comes before the Court on the Motion of the U.S. Trustee ("UST") to Convert or Dismiss this Subchapter V bankruptcy case. (Docket No. 120). The Debtor filed an Opposition to the UST's Motion. (Docket No. 143). The Subchapter V Trustee did not file a response, but she supports the UST's Motion. The Court heard the evidence and the parties' arguments on July 26, 2022. For the reasons stated below, the Court will grant the US Trustee's Motion and will convert the case to Chapter 7.

Findings of Fact

The Court, having heard the evidence, makes the following findings of fact.

A. The Debtor and His Businesses.

1. The Debtor is an individual residing in Fairfax County, Virginia. He is highly educated and financially sophisticated. He has a master's degree in aerospace engineering and a master's degree in business administration. He is a licensed real estate broker. He was employed by a hedge fund for ten years trading futures and commodities.

2. The Debtor is divorced. He lives in the former marital residence in Herndon, Virginia, which is now owned by a Trust for the benefit of his ex-wife or his children ("the Trust"). When he and his wife first separated, he paid the mortgage with Bank of America and the homeowners' association dues. His ex-wife has since paid off the mortgage. He currently does not pay the Trust any rent.

3. The Debtor operated a business known as Qidian, LLC ("Qidian"). Through Qidian, he solicited funds from individual investors which were then invested into special purpose vehicles ("SPV's"). The SPV's made mezzanine funding loans to various real estate projects. The largest of the SPV's invested in a real estate project in Miami, which suffered a foreclosure on its property by the senior mortgage lender, resulting in a loss of the SPV investors' money.

4. The Debtor had $23,279.45 in gross income for 2021. Am. Statement of Financial Affairs at 1, Docket No. 158. He received an additional $9,142.00 in dividends in 2021. *Id.* at 2.

5. He had $5,650.00 in gross income in 2022 until he filed his bankruptcy petition in April 2022. *Id.* at 1. He had an additional $5,842.00 in dividends for the first four months of 2022. *Id.* at 2.

B. The Debtor's Schedules and the Continued Meetings of Creditors.

6. The Debtor filed a Voluntary Petition under Chapter 11 with this Court on April 20, 2022. (Docket No. 1).

7. The case was filed under Subchapter V of Chapter 11. *Id.* at 1. Angela Shortall was appointed as the Subchapter V Trustee. (Docket No. 10).

8. The Debtor represented in his initial filings that "there is no Balance Sheet, Statement of Operations, or Cash-Flow Statement." (Docket No. 6).

9. The Debtor filed his first set of Schedules and his Statement of Financial Affairs (hereinafter "SOFA") on May 16, 2022. (Docket Nos. 46, 49). The Schedules and/or the SOFA have been amended four times since the initial filings. (Docket Nos. 82 (and 83, 85), 94, 106, 158 (and 159)).

10. The first meeting of creditors was scheduled for May 26, 2022. (Docket No. 11). It has been adjourned for the production of additional information four times, to ***342** June 8, 2022, June 23, 2022, July 5, 2022, and August 2, 2022. (Docket Nos. 61, 70, 97, 110).

11. The Debtor listed his monthly gross income as $2,000.00, plus dividends of $1,994.78. Schedule I, at 1–2, Docket No. 46. He stated his monthly disposable income as negative ($4,649.21). *Id.* at Schedule J, 3.

12. The Debtor did not disclose a PayPal account, nor did he disclose two cryptocurrency accounts with Coinbase and Kraken in his Schedules. (Docket Nos. 82, 83, 85, 94, 106, and 158). The Debtor disclosed these accounts in his most recent Amended Schedules. Am. Schedules/Statements at 9, Docket No. 159.

13. The Debtor also had an account at Citizens Bank, which he did not disclose. He testified that the account was originally with HSBC and that he did not realize that he had an account with Citizens. He disclosed this account in his most recent Amended Schedules. *Id.* at 4.

14. The Debtor owns membership interests in Qidian and in six limited liability companies: BAH Investments, LLC, Weymoore Ventures, LLC, Binhai Investments, LLC, Qpoint 21, LLC, HH Little Havana, LLC and 1407 Kindred, LLC. UST's Ex. 3 at 12, Docket No. 148. [1]

15. Binhai Investments, LLC, owns a 50% interest in BAH Capital, LLC. *Id.*

16. The Debtor testified that he "divested" Binhai's investment in BAH Capital in January or February 2022, for no consideration.

17. On June 22, 2022, the Debtor filed Amended Schedules. (Docket No. 94). In the Amended Schedules, he disclosed

a 50% membership interest in Prolandian, LLC, which was not previously disclosed. *Id.* at DR's Ex. 1. Prolandian was established as a construction business when the Debtor and his ex-wife were married. They each own 50% of Prolandian.

18. In his SOFA, the Debtor stated "none" (other than those listed in the Attachment to the SOFA, discussed below), when asked about transfers to family members within the year preceding the bankruptcy case. SOFA at 5, Docket No. 49.

19. In fact, the Debtor made two transfers to his cousin during that period of time. The Debtor testified that he understood this question to be asking about transfers of real estate and, not transfers of personal property such as cash. [2]

20. The Debtor has disclosed that the bankruptcy estate may have certain claims against the Trust or his ex-wife for: (a) the transfer of 1300 Cabin Creek Road in Herndon (which is now the Debtor's residence); (b) the transfer of a fractional interest in 2208 Jenson Place also in Herndon; and (c) the transfer of $300,000.00. Schedule A/B at 10, Docket No. 46.

C. The Debtor's Monthly Operating Reports.

21. The Debtor was not employed when he filed this case. The last time he received a payment from Qidian was in September or October 2021. Since then, he has been doing consulting work on a part-time basis. Schedule I at 1, Docket No. 46. He received one payment as a consultant in February 2022, and no payments since then. *Id.* at 1–2.

***343** 22. He started a new job in July 2022, at a salary of $10,000 per month. Am. Schedule I at 1, Docket No. 159.

23. The Debtor's April 2022 Monthly Operating Report ("MOR") shows $3,995.00 in income and $4,864.00 in expenses, for a loss of ($869.00) for the month. April MOR at 9, Docket No. 60.

24. The May 2022 MOR shows receipts of $1,995.00 and expenses of $1,102.00, for a gain of $893.00. May MOR at 9, Docket No. 93.

25. The June 2022 MOR shows receipts of $1,945.00 and expenses of $1,653.00, for a positive net cash flow of $292.00. June MOR at 3, Docket No. 139.

26. The Debtor did not file his MOR for July, as of September 2, 2022 (it was due on August 15, 2022).

D. The Claims in the Case.

27. The amount of the claims in this case is unclear. The Debtor's Amended Schedules indicate that there may be as much as $41,197,667.11 in claims. Am. SOFA, Official Form 106Sum at 1, Docket No. 159.

28. The Debtor acknowledges that he has a pre-petition domestic support obligation to his ex-wife in the amount of approximately $76,000.00. Schedule E/F at 14, Docket No. 46.

29. He further acknowledges that he has pre-petition, priority tax obligations in the amount of approximately $65,000.00. *Id.* at 15. As of the hearing on this Motion, he has not filed his 2021 tax returns. [3]

30. The Court's Claims Register indicates that claims totaling $10,443,129.07 have been filed in the case. The Debtor disputes many of these claims, stating that for many of them he did not sign a personal guaranty (although this might not preclude liability based on alleged fraud or securities laws theories). The Debtor testified that, in his best judgment, there are probably about $3,600,000.00 in allowable unsecured claims in the case.

E. The Debtor's Post-Petition Domestic Support Obligations.

31. The Debtor acknowledged that he was in default in his post-petition domestic support obligations in the amount of $3,000 to $4,000.

32. He is seeking to reduce his ongoing support obligations. (Docket No. 52)

F. The Debtor's Plan of Reorganization.

33. The Debtor filed a Plan of Reorganization on July 19, 2022 (hereinafter the "Plan"). (Docket No. 136).

34. The Plan calls for the liquidation of the Debtor's non-exempt assets and a distribution of the proceeds to the creditors. *Id.*

35. The Plan calls for the Debtor to pay a quarterly Dividend to the unsecured creditors of between **$5,877.44** and **$10,523.32.** *Id.* at Ex. 2, 1.

36. The Plan assumes that the Debtor will have his salary of **$10,000.00** per month, plus **$1,500** per quarter in consulting fees and **$6,068.00** per quarter in "other" income. *Id.* The source of the other income is not identified. The Plan assumes that the Debtor's income will increase approximately 15% over the 60-month term of the Plan, from $30,000.00 per quarter to $35,096.00 per quarter. *Id.*

37. Aside from the potential sales of assets (which have an unknown value), and the possibility of any recoveries from avoidance actions (again, of unknown value), the Debtor proposes to pay the entire ***344** creditor body a total of approximately $166,000.00 over a five-year period. *Id.* at 6.

38. Of this amount, approximately $134,000.00 would be paid to the domestic support obligations and the tax debt, and the remaining amount of $31,000.00 would be paid to the unsecured creditors. *Id.* at Ex. 1. [4]

39. According to the Debtor, this would result in a distribution to the unsecured creditors of **0.0045** cents on the dollar, that is, less than one-half of one cent on the dollar. *Id.* at 2.

40. The Plan calls for the Debtor to liquidate his interests in Weymoore Ventures, LLC, Binhai Investments, LLC, Prolandian, LLC, BAH Investments, LLC, Qpoint 21, LLC, HH Little Havana, LLC and 1407 Kindred, LLC. *Id.* at 9.

41. The Liquidation Analysis attached to the Plan states that the Debtor would have $36,944.81 in assets available for the creditors in a hypothetical liquidation, not including liquidation of the limited liability interests or the litigation claims. *Id.* at Ex. 1.

G. The Debtor's Amended Schedules I and J.

42. On August 9, 2022, the Debtor filed Amended Schedules I and J. (Docket No. 159).

43. His Amended Schedule I shows gross income of $10,000.00 per month, plus $2,022.75 in investment income. *Id.* at Am. Schedule I, 1–2.

44. The Debtor's Amended Schedule I does not show any income from consulting. *Id.*

45. The net income on Amended Schedule J – that is, the amount the Debtor has available to pay the Dividend under the Plan – is **$2,033.56.** *Id.* at Am. Schedule J, 3.

H. The Debtor's Amended Plan.

46. On August 12, 2022, the Debtor filed an Amended Plan. (Docket No. 167).

47. The income numbers in the Amended Plan are the same - $30,000.00 in salary per quarter, $1,500.00 in consulting income per quarter and $6,068.00 in "other" income per quarter. The salary increases are also the same. *Id.* at Ex. 2.

48. This time, however, the Amended Plan calls for a distribution of **$0.016** – or one and a half cents on the dollar – to the unsecured creditors, over the five-year life of the Amended Plan. *Id.* at 2. [5]

I. The U.S. Trustee's Motion on the Debtor's Eligibility Under Subchapter V.

49. The UST has filed an Objection to the Debtor's Designation as a Subchapter ***345** V Small Business Debtor, arguing that the Debtor is ineligible for Chapter V. (Docket No. 137). The Court set the UST's Motion for a hearing at the same time as the confirmation hearing on the Debtor's Amended Plan on September 13, 2022. (Docket No. 150).

50. The Debtor filed a response to the UST's Objection (Docket No. 249). The Debtor states that he has elected not to proceed under Chapter 11 Subchapter V. *Id.*

J. The Professionals' Fee Applications.

51. Finally, the Debtor's counsel has filed a First Interim Fee Application. (Docket No. 160). In the Application, counsel sought an award of $22,820.00 in fees and $3,689.52 in expenses, for a total of $26,511.52. *Id.* at 1–2. Counsel is holding a retainer in the amount of $15,000.00. *Id.* at 1.

52. The Court granted the Fee Application and allowed the Debtor's counsel his fees and expenses in full. (Docket No. 174). After the application of the Debtor's counsel's retainer, the bankruptcy estate will owe counsel $11,509.52.

53. Ms. Shortall, the Subchapter V Trustee, has not yet filed a Fee Application.

Conclusions of Law

The Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334 and the Order of Reference entered by the U.S. District Court for this District entered August 15, 1984. This is a core proceeding under 28 U.S.C. § 157(b)(2)(A) (matters concerning the administration of the estate).

In 2019, Congress enacted the Small Business Reorganization Act of 2019 ("SBRA"), with an effective date of February 2020. Pub. L. 116-54. The Act brought into being Sections 1181-1195 of the Bankruptcy Code, known as Subchapter V. *Id.* Debtors who qualify may elect to be treated as small business debtors when they file a petition with the bankruptcy court. *Id.* The purpose of Subchapter V was to make Chapter 11 more streamlined for the debtor and the creditors, thereby making the case less expensive and faster than a traditional Chapter 11 case. H.R. REP. NO. 116-171, at 1 (2019). Although the voting requirements are different under Subchapter V (Debtors need not have an impaired accepting class), the requirements of feasibility and good faith remain. 11 U.S.C. § 1191(a). With four amendments to Schedules (and at least one more amendment contemplated), the meeting of creditors having been continued three times, the U.S. Trustee and the Subchapter V Trustee still requesting information, and the U.S. Trustee questioning the Debtor's eligibility for Subchapter V in the first place, this case has hardly been the fast track to confirmation that Congress envisioned in enacting Subchapter V.

Section 1112(b) of the Code provides that a Chapter 11 case "shall" be converted or dismissed where there is cause. 11 U.S.C. § 1112(b)(1). Section 1112(b) does not define cause, but subsection (b)(4) provides a number of non-exclusive examples. [6] The Court finds that there is cause to convert this case to Chapter 7.

A. The Debtor's Conduct in this Case.

[1] The Court begins with an examination of the Debtor's conduct in this bankruptcy case. Every bankruptcy case carries with it an obligation of good faith. 11 U.S.C. § 1129(a)(3); *See* ***346** *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 375, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007) ("[T]he broad authority granted to bankruptcy judges to take any action that is necessary or appropriate 'to prevent an abuse of process' described in § 105(a) of the Code, is surely adequate to authorize an immediate denial of a motion to convert filed under § 706 in lieu of a conversion order that merely postpones the allowance of equivalent relief and may provide a debtor with an opportunity to take action prejudicial to creditors.") (internal footnotes omitted); *see* *In re Mitrano,* 472 B.R. 706, 710-11 (E.D. Va. 2012) (explaining that bad faith can negate the debtor's right to choose dismissal in lieu of conversion); *see also* *In re Ozcelebi,* 639 B.R. 365 (Bankr. S.D. Tex. 2022) (converting a Subchapter V case to a Chapter 7 case for bad faith conduct).

"A comprehensive definition of good faith is not practical. Broadly speaking, the basic inquiry should be whether or not under the circumstances of the case there has been an abuse of the provisions, purpose, or spirit of [the Chapter] in the proposal or plan...." *Deans v. O'Donnell (In re Deans),* 692 F.2d 968, 972 (4th Cir. 1982) (citing 9 COLLIER ON BANKRUPTCY at 319 (14th ed. 1978)). The Fourth Circuit has held that a non-exclusive list of factors might include:

> [N]ot only the percentage of proposed repayment, but also the debtor's financial situation, the period of time payment will be made, the debtor's employment history and prospects, the nature and amount of unsecured claims, the debtor's past bankruptcy filings, the debtor's honesty in representing facts, and any unusual or exceptional problems facing the particular debtor.

See *id.* (stating further that the totality of the circumstances must be examined on a case-by-case basis); *see also* *Neufeld v. Freeman*, 794 F.2d 149 (4th Cir. 1986) (holding that the court may consider prepetition conduct in determining the good faith in proposing a bankruptcy plan). [7]

[2] The Court finds bad faith conduct on the part of the Debtor for a number of reasons. First, the Debtor has not accurately and timely disclosed all of his assets. He is now on his fourth set of Schedules in the case, each amendment being prompted by inquiries from the UST or the Subchapter V Trustee. He acknowledged that he needs to amend his Schedules again to disclose the PayPal and the cryptocurrency accounts. The Debtor testified that the cryptocurrency accounts had little to nothing in them at the

time of the bankruptcy filing, but their value did not override the obligation of disclosure. *See* *Dean v. McDow*, 299 B.R. 133, 140 (E.D. Va. 2003) ("[T]here is no *de minimis* exception to the Bankruptcy Code's disclosure requirements.") He also failed to disclose Prolandian, LLC, which he owns jointly with his ex-wife.

Second, the Debtor stated "none" when asked about transfers to family members. In fact, he transferred funds to his cousin on two occasions. His testimony on this issue was not credible. It is unlikely that the Debtor, who is highly financially sophisticated, understood the term transfers of "property" to be limited to transfers of real property. SOFA at 3, Docket No. 49. At this point, four months into the case, the Court has no confidence that the Debtor's filings are accurate and complete.

***347** Third, the failure to pay post-petition domestic support obligations is an enumerated cause for dismissal or conversion in the statute. 11 U.S.C. § 1112(b)(4)(P). [8] As of the date of the hearing on this Motion, the Debtor estimated his post-petition domestic support delinquency to be about $3,000 to $4,000. The statute does not have a threshold amount; any default in the payment of post-petition domestic support obligations constitutes cause to convert or dismiss the case. *Id.*

The Court finds that the Debtor's bad faith conduct throughout this case requires that the case either be dismissed or converted to Chapter 7.

B. The Debtor's Amended Plan.

[3] Alternatively, the Court finds that there is a continuing loss to, or diminution of, the bankruptcy estate coupled with the absence of a reasonable likelihood of rehabilitation. 11 U.S.C. § 1112(b)(4)(A). There are continuing losses because the Debtor is accruing legal fees, and Subchapter V Trustee fees, that his monthly operating reports indicate he has no ability to pay. (Docket Nos. 60, 93, 139). His April 2022 MOR shows zero in income. (Docket No. 60). The MOR for May 2022 shows receipts of $1,945 and disbursements of $1,102. (Docket No. 93). The June MOR shows receipts of $1,945 and a positive cash flow of $345. (Docket No. 139). After application of the Debtor's counsel's retainer, the bankruptcy estate will owe a net amount to counsel of $11,509.52 for the first three months of the case. The Subchapter V Trustee has not yet filed a Fee Application, but she is entitled to payment of her allowed fees, as well. The Debtor has no ability to pay the ongoing professional fees in this case. The latest MOR states that the Debtor had $4,887.00 in available cash as of June 30, 2022 – and this was before the allowance of counsel's fees in the amount of over $25,000.00. June MOR at 2, Docket No. 139. [9]

Further, there is an absence of a reasonable likelihood of rehabilitation because the Debtor's Amended Plan cannot be confirmed on both feasibility and good faith grounds.

(i) *Feasibility.*

[4] The Court first examines the feasibility of the Debtor's Amended Plan. (Docket No. 167). Bankruptcy Code Section 1129(a)(11) applies under Chapter 11, Subchapter V. 11 U.S.C. § 1181(a). Additionally, in order for a plan to be considered fair and equitable, the Court must find either: (a) that the debtor will be able to make all payments under the plan; or (b) there is a reasonable likelihood that the debtor will be able to make all the payments, and the plan provides for appropriate remedies in the event of a default. 11 U.S.C. § 1191(c)(3). The Court finds that the Debtor's Amended Plan in this case meets neither standard – there is no reasonable likelihood that the Debtor will be able to make the payments under the Amended Plan.

***348** Simply put, the Debtor's Amended Plan does not work. According to Amended Schedules I and J, the Debtor has approximately $2,000.00 in monthly disposable income with which to make the Plan payments. Am. Chapter 11 Plan Subchapter V at Ex. 4, 3, Docket No. 167. The Amended Plan payments are between $5,911.79 per quarter (or $1,970.59 per month) and $10,722.39 per quarter (or $3,574.13 per month). *Id*. at Ex. 2. Once the Plan payments increase to $8,072.72 per quarter in June 2024, ($2,690.90 per month), and thereafter increasing steadily up to $10,722.39 per quarter ($3,574.13 per month), the Debtor will not have the income with which to make the Plan payments. *Id.*

Further, the Debtor's Amended I and J and his MOR's do not support the consulting income in the Plan of $1,500.00 per quarter, without which the Amended Plan is doomed from the start. *Id*. at Ex. 4. The Debtor testified that he has not received any consulting income since February 2022. He further testified that he needed to devote 100% of his time and efforts to his new employment.

The "other" income of $6,068.00 in the Amended Plan quarter equates to $2,022.00 per month. *Id.* at Ex. 2. Yet, the Debtor had only $761.83 in dividends per month ($9,142.00 divided by 12) in 2021, and $1,460.50 in dividends ($5,842.00 divided by 4) in 2022. Am. Schedules/Statements at 2, Docket No. 158. None of the MOR's to date in the case indicate the receipt of any investment income. The Debtor does not have the ability to make the Dividend payments to the unsecured creditors under the Amended Plan.

The Court finds that the Debtor's Amended Plan cannot be confirmed because it is not feasible. 11 U.S.C. §§ 1181(a), 1129(a)(11), 1191(c)(3).

(ii) *The Debtor's Lack of Good Faith.*

[5] Finally, the Court turns to the good faith requirement for confirmation. 11 U.S.C. §§ 1181(a), 1129(a)(3). The Debtor's Amended Plan is a liquidating plan. (Docket No. 167). Other than the liquidation of the Debtor's membership interests and the potential litigation claims (all of which are of questionable value), the Debtor proposes to pay his priority claims in full, and to make a distribution to his unsecured creditors of *one and a half cents on the dollar* over a five-year period. *Id.* This is, for all intents, a meaningless distribution to the unsecured creditors. [10]

[6] The Fourth Circuit has held that the prospect of a substantial repayment to creditors is not required, at least in the Chapter 13 context. *In re Deans,* 692 F.2d 968. At the same time, the Fourth Circuit noted: "Failure to provide substantial repayment is certainly evidence that a debtor is attempting to manipulate the statute rather than attempting honestly to repay his debts." *Id.* at 972. The prospect of a meaningful distribution is one factor to be considered in deciding whether a plan has been proposed in good faith. *Id.* At a minimum, the prospect of a distribution to the creditors of one and a half cent on the dollar over five years is not a reason to keep this case in Chapter 11.

There is no reason that this case should remain in Chapter 11. The Debtor's domestic support obligations and his tax debt are both non-dischargeable and will be non-dischargeable be under Chapter 7 as ***349** well. [11] His Plan, as noted, is a liquidating plan. There are no employees or jobs to save. The Debtor is now employed as a W-2 employee. The proposed distribution to the unsecured creditors is so *de minimis* that it can accurately be described as meaningless.

The Court finds that the Debtor's Plan cannot be confirmed because it fails the good faith requirement of 11 U.S.C. §§ 1191(a) and 1129(a)(3).

C. The Appropriate Remedy.

[7] **[8]** When the Court finds that there is cause, it must determine whether conversion or dismissal is in the best interests of the creditors. *In re Superior Siding & Window, Inc.,* 14 F.3d 240, 242 (4th Cir. 1994). The Court finds that a conversion to Chapter 7 is in the best interests of the creditors. 11 U.S.C. § 1112(b)(1). A dismissal without prejudice would only invite the Debtor to file the same case a second time. There would be no resolution of the creditors' claims outside of bankruptcy. The bankruptcy estate has potential claims against the Trust and the Debtor's ex-wife arising out of the transfers of: (a) the transfer of 1300 Cabin Creek Road in Herndon (where the Debtor now resides); (b) the transfer of a fractional interest in 2208 Jenson Place also in Herndon; and (c) the transfer of $300,000.00. Schedules/Statements at 10, Docket No. 46. The Bankruptcy Code provides for remedies that are not available outside of a bankruptcy case. 11 U.S.C. §§ 544, 547, 548, and 550. The Court makes no assumptions or conclusions regarding the viability or the value of these claims. However, a Chapter 7 Trustee can evaluate the claims objectively and pursue them if they are available for the benefit of the creditors.

Finally, the Court finds that there are no unusual circumstances that would cause it to find that a conversion is not in the best interests of the creditors. 11 U.S.C. § 1112(b)(2).

On balance, the Court finds that a conversion to Chapter 7 is in the best interests of the creditors.

Conclusion

The Court, therefore, will enter a separate Order under which the case will be converted to Chapter 7.

All Citations

644 B.R. 339

Footnotes

1 The UST's Exhibits will be referred to as “UST's Ex. __.” The Debtor's Exhibits will be referred to as “DR's Ex. __.”

2 These transfers still are not listed in the Debtor's Amended SOFA. *See* Debtor's Am. SOFA at 6–7, Docket No. 158.

3 The Debtor filed an Application to Employ an accountant to prepare his 2021 income tax returns on August 30, 2022, four months into the case. (Docket No. 176).

4 The Plan incorrectly places all of the priority claims into one class. *See id.* at 4–5 (stating that priority claims are to be paid “on par with the holder of any post-petition support arrearage after the payment of any allowed administrative claims ...”). This is incorrect in two respects. First, post-petition support payments are administrative claims and are entitled to be paid first. 11 U.S.C. § 507(a)(1). Second, pre-petition domestic support obligations are a first priority and are entitled to be paid ahead of all other priority claims. *Id.*

5 This is triple the proposed distribution of one-half cent on the dollar, in the Debtor's original Plan. It is not clear how the proposed distribution tripled, where the income numbers remained constant from the Plan to the Amended Plan, and where the two Plans make the same assumption as to the amount of allowed claims. *Compare* Chapter 11 Small Business Subchapter V Plan at 2, fn. 2, Docket No. 136 (“This estimated distribution share is based upon the face value of the Claims Register ($10,443,129.07).”), *with* Am. Chapter 11 Small Business Subchapter V Plan at 2, fn. 2, Docket No. 167 (“This estimated distribution share is based upon the face value of the Claims Register ($10,443,129.07 number)”.).

6 Section 1112(b)(4) uses the term “includes,” which is not limiting. 11 U.S.C. § 102(3).

7 The UST does not allege, and the Court does not find, that the bankruptcy case was filed in bad faith. The Court, therefore, need not address the subjective bad faith factor under the Fourth Circuit's decision in *Carolin Corp. v. Miller*, 886 F.2d 693 (4th Cir. 1989). The Court does find that the Debtor's Amended Plan is objectively futile, below.

8 The Debtor's Amended Plan calls for him to pay the post-petition domestic support in quarterly payments of $262.42 over the life of the Plan. Am. Chapter 11 Plan Subchapter V at Ex. 2, Docket No. 167.

9 The Debtor's Amended Plan is vague about the timing for the payment of administrative claims. *See* Am. Chapter 11 Plan Subchapter V at 4, Docket No. 167 (“Each holder of an administrative expense claim allowed under § 503 of the Code will be repaid in [specify terms of treatment, including the form, amount and timing of distribution, consistent with Section 1191(e) of the Code] [sic]”). The Court assumes that this is a drafting error that can be corrected by reference to the 60-month cash flow statement attached to the Amended Plan. *Id*. at Ex. 2.

10 Using the proposed distribution of 1.5 cents on the dollar and dividing that dividend by the 20 quarterly payments in the Amended Plan, the creditors can expect to receive 0.00075 cents on the dollar, or less than one-tenth of a cent, on their claims per quarter. (Docket No. 167).

11 11 U.S.C. §§ 523(a)(5) and (a)(1).

End of Document

TAB 28

In re Reichmeier, Case No. 18-21427 (Bankr. D. Kan.) 2020 WL 1908328

2020 WL 1908328
Only the Westlaw citation is currently available.
Designated for online use but not print publication
United States Bankruptcy Court, D. Kansas.

IN RE: John W. REICHMEIER, Debtor.
Ilene J. Lashinsky, United States Trustee, Plaintiff,
v.
John W. Reichmeier, Defendant.

Case No. 18-21427-7
|
Adversary No. 18-6072
|
Signed April 15, 2020

Attorneys and Law Firms

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Memorandum Opinion and Order Denying the U.S. Trustee's Motion for Summary Judgment

Dale L. Somers, United States Chief Bankruptcy Judge

***1** Although Debtor John Reichmeier is only twenty five years old, he has had a tumultuous few years. He graduated from college, with honors, and started a new job. He began trading in cryptocurrency and had immediate success; so much so, that he left his employment, and friends, colleagues, and family members began having him manage their own cryptocurrency funds. But then the bottom fell out. The cryptocurrency market tanked, and Debtor lost not only all of his own money, but all the money of his friends and colleagues as well. He engaged in gambling to try and recoup the losses and continued to spend money to maintain his new lifestyle at its peak. Once the truth came out, Debtor ultimately signed consent judgments in state court civil suits against him for hundreds of thousands of dollars. Debtor has now turned to bankruptcy.

The U.S. Trustee has opposed Debtor's ability to receive a discharge, filing a complaint against him alleging claims under both 11 U.S.C. §§ 727(a)(3) and (a)(5).[1] The U.S. Trustee moves for summary judgment,[2] arguing that the uncontroverted facts show that Debtor failed to maintain records from which his financial condition could be ascertained and failed to satisfactorily explain his loss of assets. The Court concludes that the U.S. Trustee has not satisfied his burden of proof to show that the uncontroverted facts establish the § 727(a)(3) and the § 727(a)(5) claims and denies the motion for summary judgment.

I. Findings of Fact, Based on Uncontroverted Facts

Debtor attended Rockhurst University and graduated *summa cum laude* in 2016 with a bachelor's degree in business administration (emphasis in finance and accounting), and a final grade point average of 3.95. After graduating, Debtor worked as an account manager for an insurance company, specializing in commercial insurance. In 2017, Debtor obtained risk management and underwriting designations from an insurance accrediting association and considered himself "pretty financially sophisticated" and "tech savvy."

In April 2017, Debtor began investing in cryptocurrency and trading on cryptocurrency exchanges online. To get started in the cryptocurrency markets, Debtor took out an $8000 loan from Lending Club, a decentralized, peer-to-peer lending network. Over the next several months, the value of cryptocurrency skyrocketed. As the value of Debtor's cryptocurrency investments shot up, Debtor also began managing cryptocurrency transferred to him by others. By December 2017, Debtor was managing more than $85,000 in cryptocurrency transferred to him by relatives, friends, coworkers, and other acquaintances.[3]

***2** In early 2018, Debtor and two of his friends—Ryan Kearns and Jackson Haney—entered into written agreements characterizing Kearns's and Haney's transfers of their cryptocurrency accounts to Debtor as loans to Debtor (at the time, $230,000 from Kearns and $50,000 from Haney).[4] According to the documents, Kearns and Haney also agreed to "loan" additional undefined sums of cryptocurrency to Debtor to manage and invest. At about the same time, Debtor entered into a virtually identical written agreement with Augustine Hanger, a friend from high school, who had already transferred $400,000 in cryptocurrency to Debtor. The agreements stated that the amounts transferred would be treated as principal, that Debtor would pay back 95% to 98% of profits as interest, and that Debtor would be liable only for losses to the principal balance.

In March 2018, Debtor left his job to focus entirely on cryptocurrency trading. Shortly thereafter, Debtor's uncle, Dennis Huber, gave Debtor a $50,000 check for Debtor to invest in cryptocurrency for him. Debtor and Huber did not sign any contract to memorialize their arrangement. In fact, other than with Kearns, Haney, and Hanger, Debtor did not have a written agreement with anyone whose cryptocurrency he managed.

Debtor's cryptocurrency, both the amounts Debtor acquired in his own name and the amounts transferred to him, were commingled and spread across multiple exchanges: Coinbase, Cryptopia, Bittrex, Gemini, and GDAX. In addition, in any given exchange or platform, Debtor would invest in multiple types of currency: Bitcoin, Litecoin, Ethereum, and Bitcoin Cash. Debtor created a spreadsheet to track, on a percentage basis, each investor's proportional share of the total pool of cryptocurrency that he was managing. The spreadsheet was updated each time anyone withdrew crypto currency, but Debtor did not save or print out historical snapshots of the proportionate share spreadsheet. The record contains an undated example showing total value of $1,689,027 allocated to 17 individuals. [5]

By mid-March 2018, the value of cryptocurrency began to decline substantially. By late-April 2018, Debtor's cryptocurrency investments had suffered significant losses. Around this time, four of the investors whose cryptocurrency Debtor managed began cashing out or withdrawing funds: on March 12, 2018, Quinn Damon withdrew $6000; on April 2, 2018, Melissa Reichmeier withdrew $10,000; on April 18, 2018, Mikey Geist (or his brother) withdrew $1800; and Kearns withdrew $200,000 in increments over time. [6]

It is undisputed that at this point, Debtor began purposefully deceiving the group he was trading for by sending emails containing inflated reports of profits. For example, on April 23, 2018, Debtor emailed Haney and attached a small spreadsheet purporting to depict the total values and total percentage returns in the cryptocurrency investments by Haney. [7] The spreadsheet purported to show that Haney's contributions—which had surpassed $100,000 by that point—had earned $86,592 in profits, for an 83% return. In reality, the value of Haney's investments and the profits were inflated. Debtor knew the profits were false. He intended for Haney, and the other investors to whom he sent similar emails, to rely on the false representations so they would not withdraw their investments, thinking he could buy time for the market to recover.

***3** In April 2018, in an attempt to recoup the loss in value of the cryptocurrency accounts, Debtor began gambling on Bovada, a Chinese sports-betting website. According to a deposit history supplied by Bovada, [8] between April 1 and May 30, Debtor transferred $127,653.38, mostly in the form of bitcoin, to Bovada. The only withdrawal was $9,500 on May 6, 2018. In addition, Debtor occasionally engaged in recreational gambling at local casinos.

By May 2018, in the face of significant losses, Debtor became panicked and desperate. In an attempt to recover his losses, Debtor began investing in more volatile forms of cryptocurrency. On May 17, 2018, Debtor emailed what he represented as another updated spreadsheet to Haney. The spreadsheet purported to show that Haney's profits were down to $81,220, for a 55% return but Debtor admits he inflated those numbers as well. Debtor also admits that he knew his representations were false when he sent the spreadsheet to Haney, and that he intended for Haney to rely on those false numbers so he would not cash out his investment.

By May 31, 2019, the cryptocurrency market had declined precipitously enough—about 85% since December 2017—that the cryptocurrency investments that Debtor was managing were mostly gone. On May 31, both Haney and Hanger told Debtor that they needed to cash out to pay taxes for their business. At that point, Debtor finally confessed to them that the money was gone. What followed was state court lawsuits by both Haney and Hanger against Debtor, alleging claims of fraud, embezzlement, and breach of contract. Debtor did not enter an appearance in those state court lawsuits and did not contest the litigation in any way. Rather, Debtor signed consent judgments in both cases, admitting that he owed the money on the claims stated. [9]

The U.S. Trustee alleges that in the months leading up to his financial collapse, Debtor liquidated large sums of cryptocurrency to spend on himself, although Debtor contests the "largeness" of those withdrawals, stating they totaled "less than $80,000." Regardless, Debtor admits that beginning in December 2017, he liquidated cryptocurrency from his accounts several times to cover personal expenses. Debtor admits to multiple withdrawals multiple times a month between December 22, 2017 and June 19, 2018, wherein Debtor withdrew cryptocurrency to make cash deposits at his bank account, most of which he used for personal expenses. Those withdrawals totaled just over $85,500 in about six months, and were used for things like a down payment on

a car, Lasik surgery, clothing, hotel rooms and vacations, payments on credit cards and Debtor's Lending Club loan, and gambling, dinners, and drinks with friends.

At his deposition, Debtor insisted he never liquidated other people's cryptocurrency to obtain money for his own personal use. Debtor instead claimed that whenever he cashed out some of the cryptocurrency, he would revise the proportional share spreadsheet to reduce his ownership percentage. That said, however, the last updated proportional share spreadsheet in the record is dated mid-April 2018; there is no document chronicling any fluctuations in any investor's share from that time forward, despite the fact that Debtor withdrew cryptocurrency for personal expenses through June 19, 2018.

***4** Debtor emptied his cryptocurrency accounts for the final time on June 19, 2018, and filed a Chapter 7 bankruptcy petition less than a month later, on July 13, 2018. In his filing, Debtor listed total assets of $18,772.29 and total liabilities of $993,402.21. Debtor asserted in his petition that his debts are *not* primarily consumer debts. The bulk of Debtor's unsecured debt is owed to four of the cryptocurrency investors: $618,000 to Gus Hanger, $50,000 to Dennis Huber, $230,456 to Jackson Haney, and $30,000 to Ryan Kearns. Debtor's petition asserts that all four claims are disputed, although at his deposition, Debtor testified that he did not dispute that he owed the debts. Debtor did not list any claims on his bankruptcy filing of any other cryptocurrency "investors."

II. Debtor's Financial Records

The U.S. Trustee's memorandum in support of summary judgment is supported by twenty two exhibits. Of these, the following relate to Debtor's cryptocurrency transactions:

- Exhibit 4. Email attachment of spreadsheet entitled "Crypto Returns 12/18/2017."
- Exhibit 5. Email attachment of undated proportional share spreadsheet.
- Exhibits 9 through 13. Emails to Hanger, Kearns, and Haney with attachments showing value of investments, which Debtor later admitted were inflated.
- Exhibit 16. Coinbase trade history (65 pages).
- Exhibit 17. Coinbase wallet (77 pages).
- Exhibit 18. Cryptopia trade history (28 pages).
- Exhibit 19. Bittrex trade history (152 pages).
- Exhibit 20. Gemini trade history (112 pages).
- Exhibit 21. GDAX transactional history (189 pages).

The transaction histories for the various cryptocurrency exchanges do not quantify profits, losses, or any changes to account balances. Rather, someone would need to go through the cryptocurrency records produced by Debtor and match up each transaction with the cryptocurrency valuation on the date of the transaction (which is not included in the documents) and compute the gain or loss on each transaction. This would involve examining the thousands of transactions at issue and matching them to the price of that particular form of cryptocurrency at that particular time. Debtor testified at his deposition that it would take him a very long time to do this sort of calculation, and he has not engaged an expert to do the accounting for him. Further, to calculate each investor's share of the gain or loss would require additional labor.

The exhibits also include two documents regarding Debtor's gambling: Exhibit 14 (Bovada deposit and withdrawal history) and Exhibit 23 (spreadsheet of casino expenditures). The Bovada records show deposits, primarily in the form of bitcoin, of $172,653.38 from April 1 through May 30, 2018. The only withdrawal is $9500 on May 6, 2018. Regarding the social gambling Debtor did with friends, Debtor produced a transaction list to the Chapter 7 trustee detailing seven instances of gambling between April 30, 2018 and May 21, 2018, totaling $1441.93. This document reflects Debtor's cash withdrawals from his bank account at the casinos, however, and does not specify gains or losses from those cash withdrawals. As to Debtor's personal finances, Exhibit 15 is the Bank of America account statements for the months of December 2017 through July 2019.

When responding to the U.S. Trustee's motion, Debtor did not provide any additional financial documents.

III. Conclusions of Law

An adversary proceeding objecting to a debtor's discharge is a core proceeding under 28 U.S.C. § 157(b)(2)(J), over which this Court may exercise subject matter jurisdiction. [10]

A. Summary Judgment Standards

***5** Federal Rule of Civil Procedure 56 requires a court to grant summary judgment "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." [11] When analyzing a summary judgment motion, the Court draws all reasonable inferences in favor of the non-moving party. [12] An issue is "genuine" if "there is sufficient evidence on each side so that a rational trier of fact could resolve the issue either way." [13] "Material facts" are those that are "essential to the proper disposition of [a] claim" under applicable law." [14] However, "an appraisal of the legal issues may lead a court to exercise its discretion and deny summary judgment in order to obtain the fuller factual foundation afforded by a plenary trial." [15]

The moving party bears the initial burden of demonstrating —by reference to pleadings, depositions, answers to interrogatories, admissions, or affidavits—the absence of genuine issues of material fact. [16] If the moving party meets its initial burden, the nonmoving party cannot prevail by relying solely on its pleadings. [17] "Rather, the nonmoving party must come forward with specific facts showing the presence of a genuine issue of material fact for trial and significant probative evidence supporting the allegation." [18] Under this Court's Local Bankruptcy Rules, "[t]he court will deem admitted ... all material facts contained in the statement of the movant unless the statement of the opposing party specifically controverts those facts." [19]

B. Section 727 Generally

Section 727 generally grants Chapter 7 debtors a discharge, "[h]owever, the expectation is that, to be entitled to discharge, the debtor must deal fairly with creditors and with the court. This obligation is imposed indirectly through a series of objections to discharge set out in Code § 727(a)." [20] The U.S. Trustee has alleged causes of action under §§ 727(a)(3) and 727(a)(5). The pertinent prohibited activities are:

> (3) the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case;
>
> ...
>
> (5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities;

"At their core, § 727(a)(3) and (a)(5) are concerned about a lack of information that prevents trustees and creditors from meaningfully examining a debtor's financial affairs or tracing his assets." [21]

As the party objecting to Debtor's discharge, the U.S. Trustee bears the burden of proof to show the elements of § 727 are met by a preponderance of the evidence. [22] "The various discharge exceptions of § 727(a) are independent, and a plaintiff need only prove the elements of one exception by a preponderance of the evidence in order to obtain a denial of discharge." [23] The Court is cognizant that "the Bankruptcy Code must be construed liberally in favor of the debtor." [24]

C. Section 727(a)(3)

***6** To state a prima facie case under § 727(a)(3), the U.S. Trustee must demonstrate that Debtor "failed to maintain and preserve adequate records and that the failure made it *impossible* to ascertain his financial condition and *material business* transactions." [25] This requirement is further explained as follows:

> In this context, 'impossible' should not be read to require a plaintiff to exhaust all theoretical means to determine the debtor's financial condition. A party objecting to discharge need show only that it cannot ascertain the debtor's financial condition and recent business transactions *from the records provided.* It is not necessary to show that there is no conceivable way to ascertain the financial condition of the debtor. [26]

A debtor's records are insufficient if courts and creditors are required to speculate about the debtor's financial history or condition, and parties should "not be compelled to reconstruct the debtor's affairs." [27] If the U.S. Trustee meets this burden,

then the burden shifts to Debtor "to justify his failure to maintain the records."[28] " 'The purpose of § 727(a)(3) is to make the privilege of discharge dependent on a true presentation of the debtor's financial affairs. This statute ensures that trustees and creditors will receive sufficient information to enable them to trace the debtor's financial history; to ascertain the debtor's financial condition; and to reconstruct the debtor's financial transactions.' "[29] The records should be sufficient for verification of the debtor's oral statements and explanation of his affairs.[30]

Debtor has stated that his debts are not primarily consumer debts. The existence of the three written contracts for the investment of substantial assets mandates this position. The Court agrees that when evaluating whether Debtor has satisfied the standard for record keeping relating to investments in cryptocurrency maintained it is appropriate to apply the standard applicable to a small business. Debtor agreed to provide investment services for family members and acquaintances. The written contracts between Debtor and Kearns, Haney, and Hanger each provided that Debtor need only remit back 95% to 98% of the profits as interest, thereby entitling Debtor to retain some profits as compensation for his services. In substance, Debtor was engaging in the business of providing cryptocurrency investment services.

"The scope of the debtor's duty to maintain records depends on the nature of the debtor's business and the facts and circumstances of each case."[31] "The long-standing rule in the Tenth Circuit is that: 'Records need not be so complete that they state in detail all or substantially all of the transactions taking place in the course of the business. It is enough if they sufficiently identify the transactions that intelligent inquiry can be made respecting them.' "[32] On the other hand, "[w]hen a debtor carries on a business involving substantial assets, 'greater and better record keeping' is warranted."[33] Debtor's business involved substantial assets; the single proportionate share spreadsheet contained in the record shows investments having a total value of $1,689,027 on behalf of seventeen individuals.

***7** The U.S. Trustee contends that the business records produced by Debtor are insufficient. As he points out, there is no documentation from which the Court can verify the cryptocurrency deposits and withdrawals of the various investors. For example, the Court cannot verify Debtor's testimony that when he made cryptocurrency withdrawals to provide funds for personal expenses, he deducted the amount from his personal cryptocurrency account. Likewise, there is no document to verify Debtor's testimony that four of the investors began cashing out or withdrawing funds in April 2018 and that they cashed out less than their account values. The presence or absence of preferential transfers cannot be ascertained. There is no documentation stating the value of the various accounts at reasonable intervals. The record contains only one example of the proportionate share spreadsheet.

Debtor states he maintained these records on an ongoing basis, until several weeks before the accounts were closed. But while these spreadsheets were maintained, they were overwritten when updated, so these records are no longer available. The exhibits include what Debtor admits were false account statements provided to some investors, but the business records do not provide a way for those investors to determine the true value of their accounts on the dates of the false statements. The voluminous transaction histories from the cryptocurrency markets show thousands of transactions, but they do not purport to show the value of even the commingled assets, much less the individual investments, on various dates. Likewise, Debtor's records of his online gambling, which was an aspect of his cryptocurrency investment business, are not complete. They consist of only deposit and withdrawal ledgers obtained from Bovada; there are no records showing the source of the deposits or the allocation of the deposits to the various individual accounts.

In response to the U.S. Trustee's motion for summary judgment, Debtor provides no additional financial records. Rather, he argues that the cryptocurrency trading records are sufficient and that the U.S. Trustee must have an expert to establish the inadequacy of the cryptocurrency accounts.

The Court finds that the summary judgment pleadings and exhibits do not provide a basis to determine if the records are sufficient or insufficient. It is clear that the records in their present form are inadequate to inform creditors, the U.S. Trustee, and the Court of the Debtor's financial transactions. They would be sufficient only if information about specific investments and trades can be reconstructed. But Debtor's testimony is the only evidence addressing what would be required to extract meaningful information from the bitcoin transaction records, and his testimony is both limited and conflicting. For example, in response to whether investors' losses could be quantified from the bitcoin transaction histories, Debtor testified that it is possible, that he could not do so, but "maybe a professional" could. Debtor stated: "You would have to go through every transaction by

this price on this date, how much that money was to sell. It would be tough because there's thousands of transactions, but I think it is possible that it could be done." [34] Later in the same deposition, Debtor testified that he could reconstruct the amounts that were lost but "it would take a very long time." [35] When responding to the Trustee's statement of facts, Debtor attempts to controvert this testimony that reconstruction would "take a very long time," by the following argument: "Assuming that an expert in cryptocurrency would use a computer program to take the cryptocurrency records that Reichmeier produced in native, excel format and associate those records with the cryptocurrency valuations of the applicable dates, it would take that expert mere seconds." [36]

***8** One of the considerations when determining if records are sufficient is "the reasonableness of the records in light of customary practices among individuals similarly situated to the debtor." [37] Here the Court has been provided no evidence concerning customary record-keeping practices when trading bitcoins, a business with which the Court is not familiar. Debtor testified that maybe a professional could reconstruct the transactions from the records provided, but there is no evidence of what expertise would be needed, how many hours of work would be required, or how much it would cost. In the particular circumstances of this case, expert opinion evidence may be necessary. Debtor was the sole person associated with his business, and therefore the only available fact witness, but he was unable to testify about the foregoing.

The Court therefore concludes that the U.S. Trustee has not satisfied his burden to establish that Debtor failed to keep sufficient records. The Court denies the U.S. Trustee's motion for summary judgment on the claim made under § 727(a)(3).

D. Section 727(a)(5)

"Under § 727(a)(5), a bankruptcy court has broad power to decline to grant a discharge where the debtor does not adequately explain a shortage, loss, or disappearance of assets." [38] "Section 727(a)(5) requires a satisfactory explanation which must consist of more than vague, indefinite and uncorroborated assertions by the debtor." [39] "The United States Court of Appeals for the Tenth Circuit has not set forth a standard for determining what constitutes a 'satisfactory explanation' of loss of assets under § 727(a)(5). Other courts have determined that such a finding is left to the sound discretion of the court." [40] Generally, "some corroboration of a debtor's testimony as to the loss or disposition of assets" is necessary and "explanations of a debtor's circumstances in general terms, that merely suggest reasons for the loss of assets, fall short of the mark." [41]

Regarding losses based on gambling, courts have generally held that "*unsubstantiated* gambling losses are a basis for a denial of discharge under § 727(a)(5)." [42]

The Court denies the U.S. Trustee's motion for summary judgment under § 727(a)(5) because the summary judgment pleadings provide an inadequate basis for exercise of the Court's discretion to deny discharge. The loss of assets is uncontroverted. It is true, as Debtor argues and as set forth in the Court's findings of uncontroverted facts, that Debtor has given a thorough explanation of what happened to those assets. But to avoid denial of discharge, the case law also requires that the explanation be corroborated. The problem is that the only source of corroboration of Debtor's explanation in the summary judgment pleadings is the Debtor's financial records, which are not transparent. Without additional evidence interpreting those records, the Court cannot determine whether Debtor's explanation of the loss of assets is corroborated.

III. Conclusion

***9** The U.S. Trustee has not established that he is entitled to judgment on his claims under § 727(a)(3) and § 727(a)(5). The U.S. Trustee's motion for summary judgment is denied.

It is so ordered.

SO ORDERED.

All Citations

Slip Copy, 2020 WL 1908328

Footnotes

1 All future references to Title 11 of the United States Code will be to section number only. Debtor appears by Paul Hentzen and Erlene Krigel. The U.S. Trustee appears by Christopher Borniger.

2 Doc. 24 (motion for summary judgment); Doc. 25 (memorandum in support).

3 These people included: Jack Reichmeier, Debtor's father; Melissa Reichmeier, Debtor's mother; Quinn Damon, a family friend and Debtor's coworker; Danny Callahan, a friend and coworker; Clint Hocker, a coworker; Austin Hannifan, a friend from high school; Jackson Haney, a friend from high school; Alex Berhorst, a coworker; Ryan Kearns, a former neighborhood acquaintance; Matt McAuliffe, a friend from high school; Katie Warren, Debtor's girlfriend; and Rob Penniston, a coworker and former high school classmate.

4 Debtor attempts to controvert this and the related facts by calling the written agreement an illegal investment contract under *S.E.C. v. W.J. Howey*, 328 U.S. 293 (1946). Debtor contends the documents are void and unenforceable. But the U.S. Trustee is not attempting to draw conclusions from the written agreements; merely stating that they existed.

5 Doc. 25, Exh. 5. All future references to exhibits attached to Docket Number 25 will be to the exhibit number only.

6 Ultimately, every other investor whose cryptocurrency Debtor managed lost the entirety of his or her investment.

7 The following scenario concerning Haney and his investments was also carried out with a man named “Joe,” but Debtor does not know Joe's last name.

8 Exh. 14.

9 Debtor argues he did not admit “the veracity of the claims” made, but he admitted at his deposition that he owed the money in the judgments based on the claims stated.

10 This Court has jurisdiction pursuant to 28 U.S.C. § 157(a) and §§ 1334(a) and (b) and the Amended Standing Order of the United States District Court for the District of Kansas that exercised authority conferred by § 157(a) to refer to the District's Bankruptcy Judges all matters under the Bankruptcy Code and all proceedings arising under the Code or arising in or related to a case under the Code, effective June 24, 2013. D. Kan. Standing Order 13-1, *printed in* D. Kan. Rules of Practice and Procedure (March 2018).

11 Rule 56 is incorporated and applied in bankruptcy courts under Federal Rule of Bankruptcy Procedure 7056.

12 *Taylor v. Roswell Indep. Sch. Dist.*, 713 F.3d 25, 34 (10th Cir. 2013).

13 *Thom v. Bristol-Myers Squibb Co.*, 353 F.3d 848, 851 (10th Cir. 2003) (citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986)).

14 *Id.*

15 10A Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, *Federal Practice and Procedure: Civil 3d*, § 2728 at 415 (4th ed.) (citing *Kennedy v. Silas Mason Co.*, 334 U.S. 249 (1948)).

16 *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986).

17 *United States v. Dawes*, 344 F. Supp. 2d 715, 717–18 (D. Kan. 2004) (citing *Anderson*, 477 U.S. at 256).

18 *Id.*

19 D. Kan. LBR 7056.1(a).

20 *Wieland v. Gordon (In re Gordon)*, 526 B.R. 376, 387–88 (10th Cir. BAP 2015) (internal quotation and alteration omitted).

21 *Hunt v. Steffensen (In re Steffensen)*, 534 B.R.180, 194 (Bankr. D. Utah 2015), *aff'd*, 567 B.R. 188 (D. Utah 2016).

22 *First Nat'l Bank of Gordon v. Serafini (In re Serafini)*, 938 F.2d 1156, 1156–57 (10th Cir. 1991).

23 *In re Gordon*, 526 B.R. at 394.

24 *Gullickson v. Brown (In re Brown)*, 108 F.3d 1290, 1292 (10th Cir. 1997).

25 *Id.* at 1295.

26 *In re Steffensen*, 534 B.R. at 197 (internal quotation omitted).

27 *In re Juzwiak*, 89 F.3d 424, 428 (7th Cir. 1996).

28 *In re Brown*, 108 F.3d at 1295.

29 *In re Steffensen*, 534 B.R. at 197 (quoting *Peterson v. Scott (In re Scott)*, 172 F.3d 959, 969 (7th Cir. 1999)).

30 *Sackett v. Shahid (In re Shahid)*, 334 B.R. 698, 707 (Bankr. N.D. Fla. 2005).

31 *Martinez v. Sears* (*In re Sears)*, 565 B.R. 184, 189-90 (10th Cir. BAP 2017).

32 *The Cadle Co. v. Stewart (In re Stewart)*, 263 B.R. 608, 615 (10th Cir. BAP 2001), *aff'd* 35 Fed. App'x 811 (10th Cir. 2002) (quoting *Hedges v. Bushnell*, 106 F.2d 979, 982 (10th Cir. 1939)).

33 *In re Sears*, 565 B.R. at 190 (quoting *Canera v. Sun Cmtys. Operating Ltd. P'ship (In re Canera)*, 550 F,3d 755, 762 (9th Cir. 2008)).

34 Exh. 1, p. 155, ll.15-25.

35 *Id.* p. 160, ll.12-25.

36 Doc. 30, p. 12.

37 4 *Norton Bankruptcy Law & Practice 3d*, § 86:9 (William L. Norton III, ed.) (citing *Johnson v. Bockman*, 282 F.2d 544, 546 (10th Cir. 1960)).

38 *Cobra Well Testers v. Carlson (In re Carlson)*, No. 06-8158, 2008 WL 8677441, at *5 (10th Cir. Jan. 23, 2008) (internal quotations and alterations omitted).

39 *Id.*

40 *Martinez v. Sears (In re Sears)*, 565 B.R. 184, 192 (10th Cir. BAP 2017).

41 *Id.*, *see also* 6 *Collier on Bankruptcy* ¶ 727.08 at 727–45 (Alan N. Resnick & Henry J. Sommer eds., 16th ed.) ("A satisfactory explanation has not been definitively defined, but the debtor probably must explain the losses or deficiencies in such a manner as to convince the court of good faith and businesslike conduct. However, lack of wisdom in the debtor's expenditures, by itself, is not grounds for denial of discharge.").

42 *Solomon v. Barman* (*In re Barman)*, 244 B.R. 896, 901 (Bankr. E.D. Mich. 2000) (citing cases) (emphasis added).

TAB 29

In re Hortman, No. AP 20-02021, 2022 WL 272146, at *7 (Bankr. D. Utah Jan. 27, 2022)

2022 WL 272146
United States Bankruptcy Court, D. Utah.

IN RE: Bennett Edward HORTMAN, II, Debtor.
Brock L. Wood; and Jackson Wood, Plaintiffs,
v.
Bennett Edward Hortman, II, Defendant.

Bankruptcy No. 19-29252
|
Adversary Proceeding No. 20-02021
|
Signed January 27, 2022

Attorneys and Law Firms

John W. Call, Nygaard Coke & Vincent, Salt Lake City, UT, for Plaintiff.

Adam D. Ford, Ford & Crane PLLC, Lehi, UT, for Defendant.

MEMORANDUM DECISION ON DISCHARGEABILITY CLAIMS AGAINST DEFENDANT

WILLIAM T. THURMAN, U.S. Bankruptcy Judge

***1** This action came before the Court for trial on November 19 and 20 and concluded on November 29, 2021 (the "Trial"). At the Trial, Plaintiffs Brock L. Wood and Jackson Wood ("Wood Cousins" or "Plaintiffs") were represented by John W. Call of Nygaard, Coke and Vincent, L.C.; while the Defendant, Bennett Edward Hortman, II ("Hortman" or "Defendant" or "Debtor"), was represented by Adam Ford of Ford & Crane, PLLC.

After receiving evidence and hearing the arguments of counsel at trial, along with considering any briefs and proposed findings of fact and conclusions of law provided to the Court, as well as a review of the record as a whole, the Court now enters the following findings of fact and conclusions of law to accompany the Court's judgement on the matter at hand. The findings and conclusions set forth herein constitute the Court's findings of fact and conclusions of law pursuant to Rule 52 of the Federal Rules of Civil Procedure, which are made applicable to this proceeding under Rule 7052 of the Federal Rules of Bankruptcy Procedure (the "Decision"). To the extent any of the following findings of fact constitute conclusions of law, they are adopted as such. To the extent any of the following conclusions of law constitute findings of fact, they are also adopted as such.

I. JURISDICTION AND VENUE

The jurisdiction of this Court is properly invoked under 28 U.S.C. §§ 157(b) and 1334. Plaintiffs' claims against Defendant are core proceedings pursuant to 28 U.S.C. § 157(b)(2)(A), and may be heard and determined by this Court. The jurisdiction of this Court is not disputed and is hereby determined to be present. The Court has similarly determined venue to be proper pursuant to the provisions of 28 U.S.C. § 1409. The Court finds notice for considering the Plaintiffs' 11 U.S.C. § 523 claims at trial to be adequate and proper in all respects.

II. SUMMARY

The Plaintiffs commenced this adversary proceeding seeking a determination that their claims against the Defendant should be determined non-dischargeable pursuant to 11 U.S.C. §§ 523(a)(4) and 523(a)(6). The Plaintiffs' main argument was that the Defendant's actions amounted to a conversion of the Plaintiffs' property, and therein constituted willful and malicious injury to the Plaintiffs under § 523(a)(6). Additionally, the Plaintiffs argue that the Defendant committed embezzlement and/or larceny under § 523(a)(4). Although mentioned during the trial, the Plaintiffs did not allege claims under § 523(a)(2) in their Complaint [1] and did in fact limit their claims at the inception of the trial to only §§ 523 (a)(4) and (a)(6). Therein, the overarching issues at hand involve the interpretation of a contract for services, how it figured in the operations and use of cryptocurrency, and subsequently how the actions leading to the contract's failure may constitute reason for claims to be nondischargeable.

III. FACTS

In compiling the factual record addressed in this decision, the Court has adopted portions of each parties' Proposed Findings of Fact and Conclusions of Law [2] and has been persuaded by particular portions of testimony presented to the Court at trial.

A. Structure and Ownership of BET Capital, LLC

***2** Addressed by both parties is the ownership and influence of Defendant Bennett Hortman, II upon BET Capital, LLC ("BET"), a Utah Limited Liability Company. Although it was stipulated as an uncontested fact in the Pre-Trial Order,[3] that the Defendant was the sole owner of BET, the testimony of Ernest Woods, Timothy Covington, as well as the Defendant, persuades the Court that all three were owners/members at the time of consequence to the current action. More specifically, the time of consequence being the lead up, execution, and subsequent failed performance of the service contract between Plaintiffs and BET.

B. Negotiation and Execution of Written Contract for Ravencoin

The allegations made by the Plaintiffs center around the execution and implementation, or the lack thereof, of a written contract between the Plaintiffs and BET. That contract was admitted and received and is entitled, the Cryptocurrency Mining Services Agreement (the "Agreement").[4]

1. Pre-Agreement Conversations and February 27, 2018 Conference Call

The parties agree that the lead-up to the execution of the Agreement began as a result of the Defendant's response to a post made by one of the Plaintiffs within a cryptocurrency interest group on Facebook; the post therein was a solicitation for crypto-mining services, specifically someone with a particular set of capabilities or know-how. The Defendant responded to the Plaintiffs' inquiry, referencing his mining company BET, and the parties set up a phone call for the afternoon of February 27, 2018 to discuss a potential business relationship. Further, although various terms in cryptocurrency are involved in this matter, this action can be boiled down to the simple terms of the Agreement, and whether/how it was breached.

As a result of these initial conversations, the Defendant began to mine Ravencoin (RVN), a form of cryptocurrency, on equipment purported to be owned solely by the Defendant within BET's warehouse. This was before the Agreement was signed by the parties. This "test run" was successful enough for the Defendant to make representations to the Plaintiffs about BET's ability to mine RVN on the February 27, 2018 conference call. During the phone call, the parties had negotiated to memorialize an agreement wherein BET would mine RVN for the Plaintiffs.

2. February 28, 2018 Execution of the Agreement

The following day, February 28, 2018, the parties executed the Agreement.[5] Pursuant to the Agreement, the Plaintiffs made two separate transfers of Bitcoin ("BTC") totaling 16 Bitcoin, on February 28 and March 1, 2018, to a cryptocurrency wallet held solely by the Defendant, as an individual, not BET. Additionally, the Agreement outlined that BET was to provide a list of equipment purchased in furtherance of this contract to the Plaintiffs as an exhibit to the Agreement, specifically Exhibit A. That list was never provided, and testimony as to why is both muddied and unconvincing.

Later on March 1, the Defendant, on behalf of BET, converted the 16 BTC to cash, and then made two separate deposits into BET's bank account for the total amount of the cash value of the 16 BTC. The Court notes, as do the parties, that any difference in value between the 16 BTC at the time of the Plaintiffs' initial transfer to Defendant, and the Defendant's transfer into BET Capital's account, was due to the market volatility of BTC.[6]

C. Failure under Contract

***3** Once the cash deposit was made into the BET account, a number of transfers took place out of the account.[7] The Court finds that each transfer was in accordance with common BET practices. BET members frequently purchased equipment via their personal credit cards or other lines of credit. Therein, the transfers that the Plaintiffs point to would actually seem to be in line with routine reimbursements by BET to its members for company expenditures. Importantly, there is nothing in the plain language of the Agreement that states, or even implies, that the Plaintiffs' payment to BET could not be used for ordinary expenses like labor or overhead, such as electricity (a large expense for crypto-mining operations). Additionally, a number of "round number" transfers by BET were either attributed to employees' wages, or to private contractors performing services for BET. Another example of ordinary expenses that were not prohibited, neither explicitly nor implicitly, by the Agreement.

Shortly after the Agreement was executed, there was a massive spike in the difficulty and cost of mining RVN,

due in most part to the coin being listed on an exchange. Each party represented that RVN's absence from a crypto-exchange was of paramount importance for entering into the Agreement in the first place, and the coin's inclusion onto an exchange increased the mining difficulty far beyond the parties' expectations.

In the days following the execution of the Agreement, and the subsequent spike in difficulty for mining RVN, the parties did discuss possible terms of a settlement to the Agreement. Although general terms were discussed, nothing near an agreement was ever made. The most specific settlement offer is contained in an April 9, 2018 email from Plaintiff Brock Wood to BET, requesting 16 BTC for settlement of the Agreement, even going so far as to represent that this request was a "haircut" due to the diminished value of BTC at the time. [8]

Nonetheless, the parties continued under the Agreement as it was executed on February 28, 2018, until BET wound down and closed shop sometime in the Summer of 2018. In that interim, the Defendant had left Utah to begin to work as a salesman in an attempt to both raise funds for BET and provide for his own family. The Defendant discussed this leaving with the Plaintiffs during the settlement discussions, instructing them to continue negotiations with his attorney, Mr. Ford. In leaving the state, the Defendant left the operations and decision-making for BET solely in the hands of Ernest Lee Woods, a co-member of BET. During this period, several business decisions were made by Mr. Woods, including the liquidation of certain coins mined, whether it be RVN or Ethereum or Bitcoin, to pay the bills of BET. The Court is persuaded by the testimony that the business decisions made during this time were in furtherance of BET's ultimate goal, which was to stay in business. Nevertheless, Mr. Woods found it necessary to close shop, without consulting the Defendant or Mr. Timothy Covington, another co-member of BET. As such, BET as a functioning business in large part ceased. Although performance under the Agreement was not due until September of 2019, the contract had all but ended with BET's closing down shop. In closing down, Mr. Woods cleared out the company's warehouse and sought to return/turnover, liquidate and hold certain equipment that was in BET's possession. This entailed Mr. Woods bringing some of BET's equipment to his own home to hold. BET never returned any equipment, or even paid or transferred anything for that matter, back to the Plaintiffs. The value and subsequent cash derived from the initial BTC payments from Plaintiffs to BET was completely consumed in payment for personal services, purchase of equipment etc., and other expenses in furtherance of the Agreement.

D. Post-Failure Posturing

The Plaintiffs brought suit against BET and three John Does in Utah state court on September 9, 2018. Default Judgment was entered against BET Capital, LLC on March 22, 2019. After an evidentiary hearing, the state court entered a judgment for $169,395.93 on April 11, 2019 in favor of the Plaintiffs, the cash dollar value of the original BTC transfers to BET. [9] On October 28, 2019, Plaintiffs amended their state action to include both Ernest Lee Woods and Bennett E. Hortman, II as individual defendants in their lawsuit against BET. [10] Subsequently on December 19, 2019, counsel for Debtor filed notice in state court of the Debtor's petition for protection under Chapter 7 of the Bankruptcy Code filed on the very same day. [11] Interestingly, the notice states: "This matter is stayed [...] as to Defendants Bennett Hortman and BET Capital, LLC (owned solely by Hortman), pursuant to the automatic stay of bankruptcy." The Court notes that this is a fairly extraordinary statement by the Defendant, as no stay had been issued by this court as to BET.

***4** Additionally taking place in the post-failure timeframe of the Agreement, it is uncontroverted that the equipment that is attributed to be in furtherance of the Agreement was disposed of by Ernest Lee Woods' delivery of the equipment to his Chapter 7 Trustee within his own individual bankruptcy case. The equipment was never returned or turned over to the Plaintiffs. Further, it is unsettling that BET never produced the list of equipment, as had been agreed to be provided in Exhibit A of the Agreement. Clearly, the business dealings between the Plaintiffs and BET appear to be inadequate and lacking in detail, which likely contributed to the fallout between the Plaintiffs and BET. It is impossible to identify any equipment that could be defined as "property" under Section 523(a)(6), let alone the value of such property to compute possible damages for claims of nondischargeability.

E. Procedural Posture and Trial

The current adversary proceeding was brought by Plaintiffs on March 18, 2020. An Amended Order Governing Scheduling and Preliminary Matters was entered on May 29, 2020, and remained in effect throughout the current proceeding. [12] Further, the Court entered the Pre-Trial Order on September 3, 2021. [13] Additionally, a Motion in Limine

was filed by the Plaintiffs on September 24, 2021, and subsequently denied on November 19, 2021.

Following the conclusion of a three-day trial on November 29, 2021, the Court took the matter under advisement until the entry of this Decision.

IV. DISCUSSION

The Plaintiffs contend that their claims against the Defendant should be determined to be non-dischargeable pursuant to 11 U.S.C. §§ 523(a)(4) and 523(a)(6). To reiterate, the scope of the Plaintiffs' claims were specifically narrowed to the aforementioned sections at trial.

In beginning the Court's discussion, it is imperative to note the evidentiary standard for Section 523 nondischargeability actions. Plaintiffs in Section 523 actions need prove each element of their claim "by preponderance of the evidence." [14] Therein, the Court reviews the Plaintiffs' allegations and arguments under this standard, and will only hold a debt to be nondischargeable upon showing that the Debtor's actions violated either § 523(a)(4) or § 523(a)(6) by preponderance of the evidence.

A. 11 U.S.C. § 523(a)(4)

To begin, § 523(a)(4) provides that a debtor may not receive a discharge from any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." Thus, if the Plaintiffs here successfully prove their claim by the preponderance of the evidence against Debtor for fraud or defalcation in a fiduciary capacity, embezzlement, and/or larceny, then their claim is nondischargeable under the applicable provisions.

1. Fraud or Defalcation While Acting in a Fiduciary Capacity

The first possible prong of § 523(a)(4) analyzed by the Court is for "fraud or defalcation while acting in a fiduciary capacity." Therefore, the Plaintiffs have to establish the following two elements to prevent the discharge of Mr. Hortman's debt: (a) a fiduciary relationship between Mr. Hortman and the Plaintiffs, and (b) fraud or defalcation committed by Mr. Hortman in the course of that fiduciary relationship. The Court analyzes this prong of § 523(a)(4) via those two elements below. However, the Court struggles to find either has been proved by preponderance of the evidence.

a. Fiduciary Capacity

For purposes of § 523(a)(4), the question of whether a fiduciary relationship is present is a matter of federal law. [15] However, "state law is relevant to this inquiry," and the Tenth Circuit requires the Court "must find that the money or property on which the debt at issue was based was entrusted to the debtor." [16] Essentially, the fiduciary relationship must be shown to exist prior to the creation of the debt in controversy. [17] "Neither a general fiduciary duty of confidence, trust, loyalty, and good faith nor an inequality between the parties' knowledge or bargaining power is sufficient to establish a fiduciary relationship for purposes of dischargeability." [18] Rather, an "express or technical trust must be present for a fiduciary relationship to exist under § 523(a)(4)." [19] Importantly here, ordinary commercial relationships do not usually qualify under this provision. [20]

***5** Upon review of the facts, the Court simply cannot find the existence of a fiduciary relationship in the context of this ordinary—albeit, unordinary industry—commercial relationship. The Plaintiffs' claim arises solely out of the Agreement, and upon careful reading of the Agreement, as well as the testimony presented to the Court, the Court finds it clear that no such fiduciary relationship arose out of the ordinary commercial relationship created by the Agreement. As such, the Plaintiffs' § 523(a)(4) claim fails the first available prong, for fraud or defalcation while acting in a fiduciary capacity, prior to even addressing any allegations of fraud or defalcation.

b. Fraud or Defalcation

Although unnecessary due to the foregoing subsection on fiduciary capacity, the Court continues its analysis of the first prong of § 523(a)(4). Thus, assuming the Court had found the existence of a fiduciary relationship, the Plaintiffs would need now establish the Debtor committed fraud or defalcation in that fiduciary capacity. However, similar to the

preceding, the Court finds that the Debtor did not commit fraud or defalcation in their failure under the contract.

2. Embezzlement

The Court now turns to the Plaintiffs' embezzlement claims under § 523(a)(4). "For purposes of § 523(a)(4), embezzlement is the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come.[21] It is hornbook law that the elements required to prove embezzlement are: (1) the entrustment, (2) of property (3) of another (4) that is misappropriated (used or consumed for a purpose other than for which it was entrusted), (5) with fraudulent intent.[22] Important to note is that embezzlement requires *animus furandi*, or the intention to steal.[23] In addition, embezzlement requires fraud in fact, involving moral turpitude or intentional wrong, rather than implied or constructive fraud.[24]

In applying these rules to the instant, the Plaintiffs' embezzlement claim fails. Although slightly related, the Court sees the Plaintiffs' embezzlement claim as twofold; one alleges the embezzlement of funds paid under the contract, the other alleges the embezzlement of equipment and/or cryptocurrency arising under the contract. Both fail.

Beginning with the allegations of embezzlement of funds paid under the Agreement, the Court finds all but one element of embezzlement absent. There was no entrustment of the funds to the Debtor, the funds were part of a bargain. The funds do represent property for purposes of embezzlement. The property was not that of the Plaintiffs, it belonged to the Debtor upon executing the Agreement. The funds were not misappropriated, there was no precise allocation of the funds stipulated to within the Agreement, and therefore BET was well within its rights to use the funds to pay wages and overhead, as well as to purchase equipment. Lastly, fraudulent intent was absent. No evidence presented show the Debtor had an intent to steal. However, the Debtor's counsel pointed out how the funds from the transferred BTC were all within the Debtor's personal account, by necessity of how cryptocurrency wallets worked at the time, and the parties stipulated to the fact that every penny was transferred into BET's account. If Debtor had an intent to steal, convincing evidence was needed which the Court cannot find here.

***6** Now onto the Plaintiffs' claim that the Debtor embezzled the equipment and/or cryptocurrency. The evidence presented requires this claim too must fail. As the Court sees it, this property was not the sort susceptible to embezzlement. The property belonged to BET, up until BET failed to perform under the Agreement. At that point, the Plaintiffs were entitled to receive the property as a sort of makeweight under the contract. The failure of BET to do so is troubling but is not embezzlement. The Court finds most of all there was no entrustment, nor was there any fraudulent intent. Had the Debtor intended to steal the property, he most likely would not have allowed Mr. Woods to retain possession of the property, let alone deliver it to the trustee in his own bankruptcy case. Similarly, the Court is not persuaded that the Debtor has embezzled cryptocurrency. In constructing the argument on behalf of Plaintiffs, seeing as they have not produced sufficient evidence trial, the Court finds the first three elements may have been satisfied in regard to any RVN mined on BET machines. However, there was no evidence at trial that any RVN was misappropriated nor was there any evidence that the Debtor had fraudulent intent in any appropriation of the RVN or cryptocurrency plausibly tied to the Plaintiffs.

3. Larceny

The Plaintiffs also alleged larceny under § 523(a)(4). The Tenth Circuit adheres to the common-law definition of larceny.[25] Under § 523(a)(4), larceny is the "felonious stealing, taking and carrying, leading, riding, or driving away another's personal property, with intent to convert it or to deprive the owner thereof."[26] The difference between larceny and embezzlement is that, "with embezzlement, the debtor initially acquires the property lawfully whereas, with larceny, the property is unlawfully obtained."[27]

Here, the Plaintiffs' larceny claim may be swiftly dealt with by the fact that no property was ever unlawfully acquired. The property that Plaintiffs claim was subject to larceny was all lawfully in BET's possession, be it the equipment or cryptocurrency. Further, assuming that was not the case, there was insufficient evidence presented that the Debtor, himself, intended to convert the equipment or deprive the owners of the equipment. Actually, there was testimony at trial that negotiations for a settlement involving the equipment were made, up until the Debtor left to reassume his job as an out-of-state salesman. Additionally, there is insufficient evidence

that the Debtor ever stole, took, carried, led, rode, or drove any of the property alleged to have been subject to larceny. As such, the Plaintiffs' larceny claim fails, and consequently the entirety of the Plaintiffs' § 523(a)(4) claim categorically fails.

B. 11 U.S.C. § 523(a)(6)

Under Section 523(a)(6), a debt arising from the "willful and malicious injury by the debtor to another entity or to the property of another entity" is to be excepted from discharge. Generally, this section was drafted with the purpose of precluding a debt arising from the debtor's tortious conduct from discharge.[28] Here, the Plaintiffs wish to bar the Defendant's discharge due to the Defendant's alleged willful conversion of the Plaintiffs' property. The Plaintiffs in their briefings correctly note that § 523(a)(6) does not include "conversion" in its statutory language, but courts have outlined that "willful and malicious injury was intended to include willful and malicious conversion."[29] Further, "conversion is generally defined as a wrongfully assumed dominion over personal property by one person to the exclusion of possession by the owner and in repudiation of the owner's rights."[30] As such, the allegation of conversion could plausibly satisfy the requirements of § 523(a)(6).

***7** "For an injury to be 'willful,' there must be a deliberate or intentional injury, not merely 'a deliberate or intentional act that leads to injury.' "[31] "A willful injury may be established by direct evidence that the debtor acted with the specific intent to harm a creditor or the creditor's property, or by indirect evidence that the debtor desired to cause the injury or believed the injury was substantially certain to occur."[32] Essentially, "to constitute a willful act under § 523(a)(6), the debtor must desire to cause the consequences of his act or believe that the consequences are substantially certain to result from it."[33] As to the "malicious" element for § 523(a)(6), the Tenth Circuit BAP best outlined the element in its *In re Johns* decision:

> Malicious injury requires a wrongful act done without just cause or excuse by a debtor who intended the resulting injury. ... The requisite intent may be established by either direct or indirect evidence. Intent of willful injury can be demonstrated indirectly by evidence of both the debtor's knowledge of the creditor's rights and the debtor's knowledge that the particularized injury will result from its conduct.[34]

Applying this interpretation of willful and malicious injury, the Court finds that the Plaintiffs have failed to establish that the Debtor's conduct was willful and malicious by preponderance of the evidence. The Court has considered the totality of the circumstances in its review of the facts presented, and the evidence shows that Mr. Hortman and his fellow members at BET fully intended to perform under the Agreement when it was executed. Further, the evidence shows that the Debtor made numerous efforts in preparation and in furtherance of the Agreement.

A lengthy amount of time at trial was devoted to BET's bank statements and analyzing various expenditures, wherein the Court sees nothing more than ordinary small business transactions albeit in the cryptocurrency world. BET made payments reimbursing its members, or affiliated parties, for equipment purchases in furtherance of the Agreement. Although the equipment was never turned over to the Plaintiffs upon BET's failure to perform, the Court finds it difficult to see that the failure to return the equipment was willful and malicious. When the Debtor left the operations for his out-of-state sales job, Mr. Woods was left in charge of the warehouse with the equipment. No evidence presented at trial points to the Debtor's intent for the Plaintiffs to never receive the equipment, and it was certainly not the Debtor's willful act for the property to be turned over in Mr. Woods' bankruptcy. An unfortunate result from objectionable business judgment, but nothing rising to the level of willful and malicious.

Further, the Court finds that the Debtor made efforts with his personal machines to ensure BET's performance under the contract was feasible, although the Plaintiffs allege this was for some nefarious purpose. The Court finds the Defendant's testimony on that point credible. The Plaintiffs' contention that this conduct was evidence of wrongdoing is not persuasive. Further, the Debtor began his research on his own machines prior to entering into the Agreement. The Court finds the Defendant's, as well as the other BET members',

testimony credible and convincing, in that it was common practice to mine cryptocurrency for personal gain on personal computers alongside company computers mining for clients. As the Court sees it, there is nothing nefarious in such a business practice. No evidence presented at trial outlines how this research injured the Plaintiffs; and even under the Plaintiffs' misinterpretation of the Agreement, insufficient evidence was presented how this research was willful and malicious. Again, the Plaintiffs' lack of understanding of this business arrangement, or how businesses in this industry operated, is not the fault of the Debtor.

***8** The discussion above outlines a persistent issue with the Plaintiffs' arguments. The Agreement as is, presents only an end-goal, and had another interpretation been the goal of the Plaintiffs then perhaps they should have bargained for such.

In addition to the foregoing, under § 523(a)(6), there must be a showing of willful and malicious injury by the debtor to another or to the property of another. The Court cannot find that willful and malicious conduct causing injury to the Plaintiffs, occurred here.

The only real possibility for the Plaintiffs to prevail under this section would be to show willful and malicious injury to the Plaintiffs' property. As discussed prior, a major problem with the Plaintiffs' case is the lack of a clear description or list of the equipment procured in furtherance of the Agreement, as was to be identified in Exhibit A. Following the execution of the Agreement, BET was to provide the list as Exhibit A to the Agreement within forty-five days; however, BET failed to do so. At trial, evidence was presented that backed the notion that equipment was purchased in furtherance of the Agreement; however, no evidence or testimony conclusively outlined the exact equipment, or any list of such, purchased in furtherance of the Agreement.[35] Based on similar testimony at trial, Plaintiffs may have made further requests for the Exhibit A list, and the list may have even been created and simply never provided, but no convincing evidence or testimony to either contention was ever produced at trial. Accordingly, the Court fails to find there was any injury to property belonging to the Plaintiffs.

In addition, § 523(a)(6) states the property must be "property of another entity." Here, although the parties casually referred to the computer equipment as the Plaintiffs' equipment, the Plaintiffs had no ownership in the actual equipment. At best, they had only a security interest in whatever equipment BET procured in order to perform under the Agreement.

Had the property Plaintiffs ascribe ownership to been specifically identified and clearly owned by Plaintiffs, and if BET had subsequently converted it somehow, the Plaintiffs would have had a better case under this section. Conversion as a cause of action is possible, in regard to secured property of another being held by a debtor; but again, the Court cannot find any identifiable property that could be either owned by the Plaintiffs or secured in their favor. The soured relationship between BET and Plaintiffs is due in large part to both parties' negligence throughout their business deal. However, mere negligence does not measure up to willful and malicious conduct.

V. CONCLUSION

There was seemingly a breach of contract by BET, specifically in its failure to turnover equipment to the Plaintiffs upon BET's failure to perform under the Agreement, as well as the defaulted noted in the state court judgment. However, the Court cannot find or conclude that the Defendant committed fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny under 11 U.S.C. § 523(a)(4), nor committed willful and malicious injury to the Plaintiffs or their property under 11 U.S.C. § 523(a)(6).

A separate judgment accompanies this Memorandum Decision.

This order is SIGNED.

All Citations

Slip Copy, 2022 WL 272146, 71 Bankr.Ct.Dec. 68

Footnotes

1 Pl.'s Complaint, ECF No. 1.

2 Pl.'s Proposed Findings of Fact and Conclusions of Law, ECF No. 35; Def.'s Proposed Findings of Fact and Conclusions of Law, ECF No. 38.

3 Pre-Trial Order, ECF No. 28.

4 Pl.'s Exhibit No. 1.

5 Pl.'s Exhibit No. 1.

6 Representations by each party point to 16 BTC at time of Plaintiffs' transfer being valued at $169,395.93; while the deposit into BET Capital's account was $169,322.16.

7 *See* Pl.'s Exhibit No. 4.

8 Pl.'s Exhibit No. 5.

9 Pl.'s Exhibit No. 6.

10 Pl.'s Exhibit No. 8.

11 Pl.'s Exhibit No. 9.

12 ECF No. 10.

13 ECF No. 28.

14 *See* *Grogan v. Garner*, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991).

15 *Fowler Bros. v. Young (In re Young)*, 91 F.3d 1367, 1371 (10th Cir. 1997) (internal citations omitted).

16 *Id.*

17 *See* *id.* (citations omitted).

18 *Id.* at 1372 (citations omitted); *see also* *Upshur v. Briscoe*, 138 U.S. 365, 375, 11 S.Ct. 313, 34 L.Ed. 931 (1891) ("Within the meaning of the exception in the bankruptcy act, a debt is not created by a person while acting in a 'fiduciary character,' merely because it is created under circumstances in which trust or confidence is reposed in the debtor, in the popular sense of those terms.").

19 *See* *Fowler Bros.*, 91 F.3d at 1371 (citations omitted).

20 *See Barenberg v. Burton (In re Burton)*, 2010 WL 3422584, at *5 (B.A.P. 10th Cir. 2010); *see also* *Holaday v. Seay (In re Seay)*, 215 B.R. 780 (B.A.P. 10th Cir. 1997).

21 *Ingram v. Nelson (In re Nelson)*, Adv. No. 13-2478, 2014 WL 1347031, at *4 (Bankr. D. Utah Apr. 4, 2014).

22 *See, e.g.*, *Yaping Lin v. Pacheco (In re Pacheco)*, Adv. No. 19-2076, 2021 WL 5985178 at *8–9, 2021 Bankr. LEXIS 3442 at *26 (Bankr. D. Utah Dec. 16, 2021); *Jordan Credit Union v. Turley (In re Turley)*, Adv. No.

10-2004, 2012 WL 369275, at *6 (Bankr. D. Utah Feb. 3, 2012); *In re Musgrave*, 2011 WL 312843, at *5 (B.A.P. 10th Cir. 2011).

23 *See In re Pacheco*, 2021 WL 5985178 at *8–9, 2021 Bankr. LEXIS 3442, at *26.

24 *See In re Nelson*, 2014 WL 1347031, at *4.

25 *Hand v. United States*, 227 F.2d 794, 795 (10th Cir. 1955).

26 *Utah Behavior Servs. v. Bringhurst (In re Bringhurst)*, 569 B.R. 814, 823 (Bankr. D. Utah 2017) (quoting *United States v. Smith*, 156 F.3d 1046, 1056 (10th Cir. 1998)).

27 *In re Bringhurst*, 569 B.R. at 823 (quoting *Wonjoog Kim v. Hyungkeun Sun*, 535 B.R. 358, 367 (B.A.P. 10th Cir. 2015)).

28 *See Caprice Capital, LLC v. Ford (In re Ford)*, Adv. No. 18-2155, 2021 Bankr. LEXIS 2997, at *35 (Bankr. D. Utah Oct. 29, 2021).

29 *In re Auto Outlet, Inc.*, 71 B.R. 674, 676 (Bankr. D. Utah 1987).

30 *Id.*

31 *In re Judge*, 630 B.R. 338, 344 (B.A.P. 10th Cir. 2021) (citing to *First Am. Title Ins. Co. v. Smith (In re Smith)*, 618 B.R. 901, 912 (B.A.P. 10th Cir. 2020)).

32 *In re Smith*, 618 B.R. at 912.

33 *Panalis v. Moore (In re Moore)*, 357 F.3d 1125, 1129 (10th Cir. 2004) (quoting *Kawaauhau v. Geiger*, 523 U.S. 57, 61, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998)).

34 *In re Johns*, 397 B.R. 544, 548 (B.A.P. 10th Cir. 2008).

35 Pl.'s Exhibit No. 4.

TAB 30

In re Sours, Case No. 21-31943 (Bankr. D. Or.) 2022 WL 4652022

2022 WL 4652022
Only the Westlaw citation is currently available.
United States Bankruptcy Court, D. Oregon.

IN RE Poondarik SOURS, Debtor.

Case No. 21-31943-dwh7
|
Filed September 30, 2022

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MEMORANDUM DECISION ON MOTIONS TO EXTEND TIME TO FILE COMPLAINTS OBJECTING TO DISCHARGE AND REQUESTING DISCHARGEABILITY DETERMINATION AND TO MOVE TO DISMISS

DAVID W. HERCHER, United States Bankruptcy Judge

I. Introduction [1]

***1** Lesbia Tejeda has moved for an extension of the deadline to file a complaint objecting to the discharge of debtor, Poondarik Sours, and to request a determination that Sours's debt to Tejeda is nondischargeable. [2] And Greg Garvin, the Acting United States Trustee for Region 18, has moved to extend the deadlines to file a complaint objecting to Sours's discharge and to move to dismiss her case for abuse. [3]

For the reasons that follow, I will grant Tejeda's and the U.S. trustee's motions to extend the discharge-objection deadline, but I will deny Tejeda's motion to extend the dischargeability deadline and the U.S. trustee's motion to extend the dismiss-for-abuse motion deadline.

II. Facts

In 2017, Sours and her husband, Timothy Sours, bought real property on Onyx Road in Terrebonne for $115,000. [4]

On September 4, 2019, Tejeda filed a state-court action against Sours. Before she filed that action, her state-court lawyer, Mike Pijanowski, had learned that Sours had an ownership interest in what he later described as two parcels of real estate. [5]

On August 9, 2021, Sours conveyed her interest in the jointly owned property to Timothy and Andrew Sours, her son, for no consideration. [6] On that day, the trial of Tejeda's state-court action was set to begin on August 31, 2021. At Sours's request, the trial was later rescheduled to begin in September 2021. [7]

Sours filed her petition initiating this case on September 16, 2021. [8] Her bankruptcy lawyer was Theodore Piteo. She said that her debts are not primarily consumer debts [9] and that she lived at an address in Beaverton. [10] With her petition, she filed her Schedule A/B [11] property schedule and Schedule C [12] claim of exempt property, neither of which listed any real property. She also filed with her petition a Statement of Financial Affairs (SoFA) in which she said that during the last three years she had not lived anywhere but where she then lived. [13] In the SoFA, she answered "no" to whether she had made any out-of-ordinary-course property transfers within the last two years. [14]

The meeting of creditors was on October 14, 2021. [15] When Eiler asked Sours whether she had "given away" any property worth more than $2,000 during the past two years, she did not mention her transfer of the property. [16]

On November 8, 2021, Pijanowski emailed Piteo. [17] After introducing himself as Tejeda's state-court lawyer, [18] he said that, before filing the state-court complaint, he had learned that Sours had an ownership interest in what he described as two parcels of Oregon real estate, one of which he had learned that she quitclaimed in August 2021. He attached to his email to Piteo a copy of the quitclaim deed. He had noticed that what he referred to as "the petition" had no information about the property transfer, which "was for less than value" because the property had been bought for $115,000 in 2017 but conveyed in consideration of what he thought was $200. Pijanowski concluded by asking Piteo why "the transfer (or asset) wasn't included in the schedules."

***2** On November 22, 2021, Pijanowski emailed Kenneth Eiler, the case trustee, with the same information he had sent to Piteo on November 8, including the deed. [19]

Also on November 22, Eiler forwarded Pijanowski's email to Christian Torimino, a lawyer for the U.S. trustee, adding that the transferred property was valued by Zillow at more than $600,000. Eiler also relayed that Sours "has a sizeable, $11,000+ crypto account," which "suggests some sophistication as far as buying and holding crypto currency," and "[i]f she hid this real property transfer, she may be hiding more crypto." [20] November 22 was Monday of Thanksgiving week, a shortened holiday week for Torimino. Torimino took two sick days the week of November 29 through December 3. [21]

On December 2, Torimino emailed Piteo to request consent to a Federal Rule of Bankruptcy Procedure (Rule) 2004 examination of Sours and extension of the discharge-objection deadline to accommodate a 14-day examination notice. [22] The automated email reply from Piteo stated that he was out of the office until December 6. [23]

On December 7, Piteo responded to Torimino, saying that Piteo was having trouble contacting Sours and would be moving to withdraw. [24] Piteo filed that motion on December 10, 2021. [25]

Also on December 7, Justin Leonard filed a notice of appearance in this case on behalf of Tejeda. [26]

And he followed up on Pijanowski's November 22 email to Piteo, who promptly responded that he had not been able to confer with Sours and did not respond again until after the extension motion was filed. [27] In Piteo's email to Leonard of 4:54 p.m. that day, he said that "the U.S. trustee is already sniffing around so I don't think your client needs to be too concerned about the 523/727 deadline." [28] In Leonard's email to Piteo of 5:01 p.m. that day, he said that Tejeda wanted to preserve the ability to file a 523 complaint "or" a 727 complaint. He said he believed that "523 may apply to at least some of our client's claim, so I expect we will want to file a complaint unless we can negotiate a stipulation." [29]

On December 10, Sours filed both an amended Schedule C and an amended SoFA. The amended SoFA includes pages 1 and 8 of the 12-page form. She also filed a signed custom-prepared notice of amendment. She did not file with the amended documents Official Form 106-DEC, the form Declaration About an Individual Debtor's Schedules. The amended Schedule C claims an exemption in real property at Onyx Road. [30] The amended SoFA states that (1) Sours lived at Onyx Road "From Jan/2017 To Dec/2021," (2) the property is worth $348,810, and (3) she transferred it on August 9, 2021, to Timothy and Andrew for no consideration. [31] The December 10 amendments did not amend the property Schedule A/B.

On December 13, 2021, Piteo moved to withdraw. [32] On December 30, he filed an amended motion for leave to withdraw. [33]

***3** On January 7, 2022, Eiler filed a complaint initiating an adversary proceeding against Timothy and Andrew seeking to avoid and recover Sours's transfer to them. [34] On April 13, Eiler filed an amended complaint, in which he alleged that, on January 28, 2022, Timothy and Andrew executed and recorded a quitclaim deed to Sours and Timothy in an apparent attempt to undo the 2021 transfer. But Eiler also alleges that the 2022 deed's legal description does not match that in the 2021 deed, requiring him to continue the adversary proceeding. [35] Eiler also added to the complaint a claim for a determination that he may sell the entire interest in the property under section 363(h). [36]

III. Motions, briefs, and argument

The extension motions were filed on December 13, [37] the deadline—60 days after the first date set for the meeting of creditors—imposed by Rules 4007(c) and 4004(a) to file actions under 11 U.S.C. §§ 523 and 727 to determine that a debt is nondischargeable and to object to a debtor's discharge and the deadline under Rule 1017(e) to move under section 707(b)(1) and (3) to dismiss this case for abuse. (Other section references are also to title 11.)

The U.S. trustee's motion states that he "is investigating" Sours's transfers of possible estate assets including real property." [38] The motion describes unsuccessful attempts to arrange through Piteo for a Rule 2004 examination of Sours. [39] And it seeks extension of the Rule 4004(c) deadline to bring a discharge-objection action and the Rule 1017(e) deadline to move to dismiss this case for abuse.

In Tejeda's motion, she states that she has "questions and concerns" about (1) Sours's "assets and undisclosed pre-petition transactions of real property that implicate 11 U.S.C. § 727," (2) "whether at least a portion of Movant's claim is nondischargeable under 11 U.S.C. § 523," and (3) "whether [Sours] would agree to stipulate to a resolution to avoid the expense of further litigation regarding Movant's claims."[40] Tejeda describes multiple requests over "nearly a week" for additional information from Piteo, to which Leonard received no substantive response.[41] And she argues that cause exists for extensions of both deadlines because she "is continuing her investigation of [Sours's] assets, disclosures, and prepetition activities diligently, and will continue to attempt to resolve her issues consensually with" Sours.[42]

On December 28, 2021,[43] Sours filed a response to Tejeda's motion, contesting Tejeda's debt claim against Sours and labeling Tejeda's extension motion as "last minute" because it was filed on the deadline.

On December 29, Leonard filed a declaration in support of Tejeda's motion, specifically addressing Sours's argument that Tejeda's motion is "last minute." He laid out the timeline of steps, described above, taken by himself and Pijanowski. Leonard requested the extension "to seek additional informal discovery" or to arrange a Rule 2004 examination of Sours "and possibly third parties to inquire regarding other potential assets of the Estate that have not yet been disclosed."[44]

On January 4, 2022, I granted Piteo's withdrawal motion.[45]

On January 12, 2022, Sours filed a letter objecting to the extension motions as "last minute."[46]

Also on January 14, Leonard filed an amended declaration in support of Tejeda's extension motion. According to that declaration—Sours's filings on December 10[47] and 23[48] "alone demonstrate failure to disclose assets and transfers, which is indeed one reason to deny the Debtor's discharge."[49] The 60-day deadline extension is needed to seek additional informal discovery to inquire about other potential assets of the estate that have not yet been disclosed, as well as to evaluate the intent behind the representations and the transfer.[50]

***4** On January 14, 2022, Torimino filed a declaration and a brief in support of the U.S. trustee's motion.[51] In the declaration, he laid out the timeline of steps that he took after receiving Eiler's email on November 22, 2021. Before November 22, his office "essentially had no knowledge of this case or this debtor beyond the routine analysis of the § 707(b)(2) means test (which did not apply because Debtor has primarily non-consumer debts."[52] "[o]ur office believed when the Motion was filed that further discovery (specifically, a deposition) was necessary to determine [Sours's] interest in trusts and [her] state of mind" when she transferred real property "weeks before the bankruptcy filing" and failed to disclose the transfer in her SoFA and in response to Eiler's question at the meeting of creditors. He also pointed to Sours's December 28 letter,[53] which he said "strongly suggests that there may be merit to an action under § 727 or § 707(b)(3)."[54] He reported that he had discussed with Sours a potential Rule 2004 examination.[55] In his experience, the vast majority of U.S. trustee investigations into potential actions against debtors "proceed informally and consensually," and debtor cooperation often results in his office "concluding our investigation and allowing Debtors to proceed to discharge without defending motions or complaints that may lack merit."[56] The motion is warranted by the need to correspond with "a now *pro se* Debtor on complicated motions or complaints that may lack merit." Despite claiming to need to examine Sours about "her interest in trusts," he does not explain the basis of any suspicion that she has an undisclosed interest in trusts.

In Torimino's brief, his said that the U.S. trustee has "concerns that there may be other false statements in the schedules, particularly involving cryptocurrency and an interest in a trust." In his declaration, the only mention of cryptocurrency was Eiler's suspicion that Sours's hiding of the real-property transfer suggests that she might also be hiding cryptocurrency in addition to the amount that she did schedule. And Torimino's only mention of a trust was his stated belief that he needed to examine Sours about her "interest in trusts." He does not state in the declaration or brief any basis, other than Sours's hiding of the real-property transfer, for suspecting that Sours underdisclosed her cryptocurrency or failed to disclose any trusts.

On January 28, Sours filed a declaration responding to both extension motions.[57] She challenges at least the U.S. trustee's motion, and perhaps both motions, as "a last-minute claim"

because the motions were filed on the deadline of December 13, and she points out that more than four months has passed since the petition date. She also attributes what she refers to as "mistakes" to the "language barrier I struggle with." She claims to "have trouble reading, writing and understanding information in the English language" and does "not feel confident in my ability to understand and answer questions in a professional setting in English." She asserts that "it would have been proper if I had a translator during my questionnaire in the bankruptcy process." Nothing earlier in the record identified her language barrier.

IV. Statutes, rules, and case law

A. Statutes and rules

A chapter 7 debtor is entitled to a discharge of debts unless there exist any of 12 conditions in section 727(a). One of the conditions is that the debtor, with intent to hinder, delay, or defraud a creditor, transferred the debtor's property within one year before the petition date.[58] Another is that the debtor has knowingly and fraudulently, in or in connection with the case, made a false oath or account.[59] The U.S. trustee, a creditor, or the case trustee may object to the discharge on any of the 727(a) grounds.[60] An objection is made by filing a complaint initiating an adversary proceeding.[61] I will refer to a discharge-objection complaint as a 727 complaint.

Once entered, the discharge covers most but not all prebankruptcy debts.[62] Under section 523(c), certain kinds of debts can be excepted from discharge, but only if the court determines the debt to be nondischargeable in response to a complaint the creditor files. I will refer to a complaint to determine the dischargeability of a debt as a 523 complaint.

Section 707 governs dismissal of a chapter 7 case. Under section 707(b)(1), the court can dismiss a chapter 7 case filed by an individual with primarily consumer debts if relief would be an abuse of chapter 7. Under section 707(b)(3), in considering whether to dismiss a case as abusive, the court must consider whether the petition was filed in bad faith or the totality of the circumstances demonstrates abuse.

***5** The deadline to file 523 and 727 complaints and dismiss-for-abuse motions is 60 days after the first date set for the meeting of creditors. That deadline applies to a 523 complaint under Rule 4007(c), to a 727 complaint under Rule 4004(a), and to a dismissal motion under Rule 1017(e). If no timely 727 complaint is filed, the bankruptcy court must grant a discharge "forthwith."[63]

The court can extend the 60-day deadline "for cause." That's permitted by Rule 4007(c) for a 523 complaint, Rule 4004(b)(1) for a 727 complaint, and Rule 1017(e)(1) for a dismissal motion.

None of the rules defines "cause."

B. Case law applying Rules 4007 and 4004 to 523 and 727 complaints

Because Rules 4004 and 4007 both address whether and to what extent a debtor should receive a discharge, courts have recognized that "the standard for application of the time limits in those Rules should be consistent."[64] And because both rules set the identical 60-day deadline and permit extensions only for cause, cases interpreting Rule 4007(c) apply in interpreting Rule 4004(b).[65]

1. *Willms v. Sanderson*

No U.S. Supreme Court case defines cause for extension of the deadline.

In the Ninth Circuit's 2013 decision in *Willms v. Sanderson*,[66] the court interpreted cause in Rule 4007(c), disagreeing with the bankruptcy court's extension of time for two creditors to file a 523 complaint. The creditors timely requested extension of the 727 deadline and only later sought and obtained extension of the 523 deadline.

As its first ground for reversal, the court held that the bankruptcy court could not treat the timely request to extend the 727 deadline as including a request to extend the 523 deadline.[67] Thus, the 523-extension request was untimely.

But an alternate ground for the court's reversal was that the bankruptcy court did not make a finding of cause for the extension.[68] To show cause under Rule 4007(c) for extension of the 523 deadline, the extension motion must "show cause why the extension is necessary."[69] The only cause the creditors asserted was that "they needed additional time 'to complete an investigation and evaluate whether or not a complaint objecting to discharge or amotion to dismiss

is warranted.' " It was "critical" that "they failed to explain *why* they did not complete their investigation prior to the deadline." The court acknowledged that "the 'cause' standard may be a lenient one," but nonetheless held that—

> accepting the [creditors'] request for more time so that they could determine whether or not they even *had* a viable argument for nondischargeability—without any explanation why they could not have made this determination within the time set by Rule 4007—would render the standard toothless. [70]

Willms includes the following sentence, cited by Tejeda: "At a minimum, 'cause' means excusable neglect," citing the Supreme Court's 1993 decision in *Pioneer Inv. Servs. Co. v. Brunswick Assocs. LP.* [71] In a footnote after that sentence, the *Willms* court described *Pioneer* as having—

> ***6** embraced the factors that we previously identified as relevant to determining the existence of excusable neglect: (1) whether granting the delay would prejudice the debtor; (2) the delay's length and impact on efficient court administration; (3) whether the delay fell within the reasonable control of the person whose duty it was to perform; (4) whether the creditor acted in good faith; and (5) whether clients should be penalized for the mistake or neglect of their counsel. 507 U.S. at 385, 113 S.Ct. 1489. [72]

As the cause-analysis framework is articulated in *Willms*, the requirement that the creditors show that they could not have timely determined whether they had a viable ground for complaint is a requirement, rather than one of several factors that the bankruptcy court should consider. Thus, if the movant was able to determine timely whether it had a viable ground for complaint, whether or not it had actually made that determination, the analysis stops, and the motion must be denied.

The *Willms* framework for determining cause appears unique to this circuit. The court of appeals has not addressed the issue in a precedential decision since *Willms*.

One definition of viable is "capable of working, functioning, or developing adequately." [73] Whether a complaint initiating a civil action is viable should be determined considering its intended purpose. A complaint is filed not just to survive motions to dismiss and for sanctions, but also to obtain and enforce a judgment. Thus, a creditor who has only enough information to prepare and file a complaint that would survive motions to dismiss and for sanctions, but not the additional information necessary to determine that the creditor **has** a reasonable likelihood of prevailing at trial and that the litigation benefit is worth the cost and risk, would not be able, within the meaning of *Willms*, to file a viable complaint.

2. Other decisions

Because the *Willms* creditors gave no reasons why they were unable to meet the 523 deadline, the Ninth Circuit did not address factors that other courts have considered in determining whether cause exists for an extension. Among the oft-cited lists of cause factors is the five-factor list in *In re Nowinsksi*, a 2003 Southern District of New York bankruptcy decision: [74]

- whether the creditor had sufficient notice of the deadline and the information to file an objection;
- the complexity of the case;
- whether the creditor exercised diligence;
- whether the debtor refused in bad faith to cooperate with the creditor; and
- the possibility that proceedings pending in another forum will result in collateral estoppel on the relevant issues.

Expanding on the fourth factor, the *Nowinski* court held that "[w]ithout a finding of bad faith on the part of the debtor, however, mere recalcitrance in discovery does not support a finding of cause."

3. Excusable neglect

It's difficult to know what to make of *Willms*'s reference to excusable neglect and citation to *Pioneer*. Excusable neglect does not appear in Rule 4007(c) as a ground for extension of the 523 deadline; neither does it appear in Rule 4004(b)(1).

***7** The only rule where "excusable neglect" does appear is Rule 9006(b)(1). There, it's the prerequisite for extension of deadlines that have expired—those that have been neglected, hence the reference to excusable neglect: neglect that is excusable. But by its terms, Rule 9006(b)(1) simply does not apply to requests for extension of the 523 and 727-complaint deadline. That's because it expressly excludes Rules 4004(a) and 4007(c) from the effect of Rule 9006(b)(1). [75] The Supreme Court observed in *Pioneer* that Rule 9006(b)(3) "enumerates those time requirements *excluded* from the operation of the 'excusable neglect' standard." [76]

Rule 9006(b) does set cause as a prerequisite for any deadline extension request, whether or not timely. In *Pioneer*, the creditor failed—neglected—to timely file its proof of claim in a chapter 11 case, and it made a late request for extension of the deadline to file its claim, so it had to demonstrate excusable neglect. The Court addressed factors to consider when determining whether a creditor had demonstrated excusable neglect, warranting an extension of the claim-filing deadline. But whether the creditor satisfied the general requirement of cause for the extension was neither at issue nor addressed.

Here, when Tejeda and the U.S. trustee filed their extension motions on December 13, they hadn't neglected to do anything; the deadline to file complaints hadn't run, so they hadn't yet neglected to file complaints, and for that reason they also hadn't neglected to file their extension motions, which they timely filed. For that reason, the language of the rules and logic suggest that *Pioneer* and excusable neglect have no application to Rule 4007(c), and there was no apparent reason for the *Willms* court to address them in the context of interpreting cause. After the single sentence mentioning excusable neglect, the court does not mention excusable neglect again while addressing whether the creditors established cause for a deadline extension.

Statements in a precedential Ninth Circuit decision that are "made in passing, without analysis, are not binding precedent." [77] Conversely, a statement is circuit law if an issue was "presented for review," addressed by the court, and decided in an opinion joined in relevant party by a majority of the panel, all regardless of whether it was in some technical sense "necessary" to the disposition. [78]

Both Tejeda and the U.S. trustee suggest that the Ninth Circuit's statement that "at a minimum, 'cause' means excusable neglect" means that the existence of excusable neglect always constitutes cause. [79]

I disagree, for two reasons. First, the plain meaning of the single sentence mentioning excusable neglect and *Pioneer* is not that a showing of excusable neglect always constitutes cause. Rather, it means that the cause standard is no less demanding than the excusable-neglect standard. It does not mean that satisfying the excusable-neglect standard also constitutes cause for an extension.

***8** Second, the Ninth Circuit discussed the facts of *Willms*—specifically, the creditors' failure to show that they could not have determined whether they had a ground for a 523 complaint by the original deadline—only in the context of whether those facts constituted cause for an extension. The court did not discuss how the *Pioneer* excusable-neglect factors would apply to those facts.

I have found no post-*Willms* decision holding that excusable neglect is a standard for finding cause under Rule 4007(c) or 4004(b). Seven years after *Willms*, in a 2020 nonprecedential Ninth Circuit BAP decision, *In re Emond*, the court evaluated cause for a Rule 4007(c) extension without mentioning excusable neglect, then reversed the bankruptcy court's 523 extension because the extension request included no explanation "why the creditor could not file the complaint within the original deadline." The court mentioned *Willms* only as authority for applying an abuse-of-discretion standard of review to a bankruptcy court's decision to grant a 523 extension. [80]

4. Summary: meaning of cause

Although the Ninth Circuit in *Willms* said that an extension motion must "show cause why the extension is necessary," it didn't expand on the meaning of "necessary"—and it had no reason to under the facts there. Under the most exacting meaning of necessary, an extension could necessary in the

sense that the filing of the complaint based only on the information then available to the movant would violate a court rule, either because it fails to allege facts plausibly stating a claim on which relief can be granted, warranting dismissal under Federal Rule of Civil Procedure 12(b)(6), or that its factual contentions lack evidentiary support and will not likely have that support after a reasonable opportunity for further investigation or discovery, in violation Rule 9011(b)(3). A less-exacting meaning of necessity would take into consideration the real-world considerations of a reasonable litigant, who, in addition to avoiding dismissal or sanctions, would often reasonably prefer to use all readily available sources of information to determine that there is a reasonable likelihood of prevailing at trial and that benefits of prevailing outweigh the costs. I have found no case authority adopting either sense in evaluating cause, but the less-exacting standard more properly balances the statutory interests in granting the discharge to the poor-but-honest debtor, as reflected both in the discharge and the dischargeability and discharge exceptions.

C. Case law applying Rule 1017(e) to 707(b) dismiss-for-abuse motions

The Supreme Court has recognized the normal rule of statutory construction that "identical words used in different parties of the same act are intended to have the same meaning."[81] The same principle should apply to Rules.[82] Rules 1017(e), 4004(b), and 4007(c) all have the same "for cause" standard to extend a deadline expiring 60 days after the first date set for the meeting of creditors. So, the analysis above of cause in Rules 4004(b) and 4007(c) should equally apply to cause in Rule 1017(e), governing the deadline to file a section 707(b) dismiss-for-abuse motion.

V. Application of excusable-neglect factors to 727 motions

***9** Despite my conclusion that *Willms* doesn't require that a showing of excusable neglect to establish cause for a deadline extension, I will address the specifics of the pending 727 motions in the context of the five excusable-neglect factors listed in *Willms*.

A. Whether granting the delay would prejudice the debtor

Any delay in granting the discharge will always prejudice the debtor by depriving the debtor of early repose—the certainty that no dischargeability or discharge-objection litigation can be commenced. But the debtor's interest in repose is mediated by the interest in limiting the discharge, evident in the dischargeability and discharge exceptions.

Here, Sours was alerted as early as November 8 of concern about the property transfer, and her incomplete and contradictory December 10 filings created uncertainty regarding whether the transfer had occurred or had been reversed. Any prejudice to Sours of the requested extension is minor and appropriate and does not weigh against granting the extension.

B. The delay's length and effect on efficient court administration

The length of the requested delay (extension) is 60 days, which, had I granted the motions immediately, would have expired on February 11, 2022, and would not have negatively affected court administration. I cannot charge against any party the additional time for which I have had the motions under consideration. In any case, Eiler is now prosecuting an adversary proceeding to avoid the property transfer, so even with the time I have taken to decide the motions, granting the requested 727 extension is still unlikely to negatively affect efficient court administration.

C. Whether the delay fell within the reasonable control of the person whose duty it was to perform

Based on the deed, its nondisclosure in the original SoFA or at the meeting of creditors, and the pending Tejeda litigation, Tejeda and the U.S. trustee could have timely filed complaints under section 727(a)(2)(A) and (a)(4).

But Sours's filings on December 10—three calendar days and one business day before the deadline—were incomplete and inconsistent, creating uncertainty about whether the transfer had actually occurred or had been reversed. Listing the property in the amended Schedule C is consistent with her having owned the property on the petition date (and not having previously transferred it), but it's inconsistent with the property's absence from an amended Schedule A/B (none was filed then) and the statement in the amended SoFA that she transferred it on August 9 for no consideration. The legal efficacy of every statement she made in those filings is in question because she didn't file with the amended Schedule C the required Official Form 106-DEC, the form Declaration About an Individual Debtor's Schedules, and she filed only two pages of the amended SoFA, without its signature page.

Neither of the possible scenarios suggested by the December 10 filings would eliminate any possible 727 claim. If the property hadn't been transferred, it should have been listed on Schedule A/B, and if it was transferred, the transfer should have been listed in the SoFA—even if the property was later returned. But if the property hadn't been transferred, a claim under section 727(a)(2)(A) would be inappropriate. And depending on the value of the equity in the returned property and the amount of allowed claims in the case, the reversal could enable creditors to be paid in full, eliminating any economic benefit of dischargeability or discharge-objection litigation. Here, Sours scheduled unsecured claims of $80,274 and no secured claims;[83] before January 4, 2022, the filed proofs of claim totaled $41.284.05;[84] Sours valued the property at $348,810; and Eiler earlier thought it was worth $600,000. Thus, as of December 10, Tejeda and the U.S. trustee could have thought that they needed to confirm whether the property had in fact been returned, because the return would both remove the basis for a section 727(a)(2)(A) claim and require evaluation whether the estate would be solvent, making any discharge-objection action uneconomical.

***10** From December 7, when Piteo's firm had been asked by Sours to withdraw, until after the December 13 deadline (through January 4, 2022, when I granted Piteo's December 13 motion to withdraw), any attempt by Leonard and Torimino to communicate with her through Piteo to persuade her to voluntarily submit to examination or to schedule a compelled examination would apparently have been futile, and any direct communication would have been unethical.

A movant's need to investigate whether a discharge-objection action is economical is something that a reasonable litigant, especially if advised by a responsible lawyer, "needs" to do. In the ordinary case, information to make the cost-benefit evaluation will be available at or soon after the petition date or at least the meeting of creditors, or the absence or late discovery of that information cannot be charged to the debtor. But in this unusual case, it was Sours's filings shortly before the deadline that created the need to evaluate whether the transfer had actually occurred and, if it hadn't, whether a discharge-objection action would thus be uneconomical. When the impetus for the investigation arises shortly before the deadline, investigation is necessary, constituting cause for an extension under *Willms*. That's particularly true because discouraging the filing of a well-founded but uneconomical action advances not just the interest of the movant but also the debtor's interest in not having to defend a discharge-objection action, albeit at the cost of some delay in receiving repose.

Thus, I find that the delay was not in the reasonable control of Tejeda or the U.S. trustee.

D. Whether the creditor acted in good faith

Tejeda and the U.S. trustee sought in a professional and progressive manner (if not, in retrospect, as fast as would have been ideal) to obtain information from which to evaluate whether it would be both technically proper and economical to bring a discharge-objection action. I thus have no basis to find that they acted in bad faith.

E. Whether clients should be penalized for the mistake or neglect of their counsel

Under *Pioneer*, a court evaluating excusable neglect must attribute to a client the fault of its lawyer.[85] I have not failed to attribute to Tejeda and the U.S. trustee the actions of their lawyers, who I have noted could have acted sooner. But I have nonetheless found that the circumstance as a whole establish cause to extend the discharge-objection deadline.

F.* Nowinski *cause factors

Of the five *Nowinski* cause factors discussed in part IV.B.2 on page 16 above—

- Neither Tejeda nor the U.S. trustee denies sufficient notice of the deadline.
- This case is not unusually complex for the chapter 7 of an individual small-business owner. I have addressed the ambiguity introduced by Sours's December 10 filings, which weighs in favor of the requested extension that I will grant.
- I have alluded to Tejeda's and the U.S. trustee's diligence above, mentioning that they—particularly Tejeda—could have acted sooner. I could not find that Tejeda acted diligently before December 10; she could and should have sought formal discovery promptly after not hearing back from Piteo. I could find that, marginally, that the U.S. trustee had acted diligently before December 10 due to the late date on which Eiler communicated with Torimino. But the ambiguity introduced by Sours's December 10 filings outweighs Tejeda's lack of diligence before December 10.

***11** • It's not clear what "bad faith" means in the *Nowinski* factors list. I don't find that Sours sought, or even expected, to mislead by refusing to communicate with Piteo so he could respond to multiple lawyer inquiries. But I do find that she knew or should have known that the inquiries were reasonable and would be pursued, so her failure to communicate with Piteo weighs against her and in favor of a cause finding.

- There was no possibility that proceedings in another forum would result in collateral estoppel on relevant issues.

G. Other grounds for cause argued by the parties

Because I will grant Tejeda's and the U.S. trustee's 727-extension motions, I need not and will not address any of their supporting arguments that I have not otherwise addressed.

VI. Cause to extend 707(b) deadline

The U.S. trustee's motion does not address section 707(b)'s limitation to debtors with primarily consumer debts, and the U.S. trustee acknowledges that Sours claims to have primarily nonconsumer debts and does not dispute that fact.

Without some suggestion that, in fact, Sours's debts are primarily consumer, no section 707(b) motion could be filed. I thus cannot find cause to extend the deadline to file such a motion.

VII. Tejeda's motion to extend 523 deadline

In Tejeda's motion, she states that she has "questions and concerns" about "whether at least a portion of Movant's claim is nondischargeable under 11 U.S.C. § 523," but she does not state what those questions are. She later alleges that she "is a valid creditor who can file a complaint under 11 U.S.C.... § 523"[86] and that "at least a portion of [her] claim is nondischargeable under 11 U.S.C. § 523 ...."[87] She makes no other specific arguments in support of her request to extend the section 523 deadline or why she was unable to timely file a 523 complaint, such as any postpetition act or omission of Sours that prevented Tejeda from filing a 523 complaint.

Under *Willms*, to establish cause for extension of the 523 deadline, a movant must offer at least an "explanation why [the movant] could not have made this determination [whether the movant had a viable 523 claim] within the time set by Rule 4007." Absent that explanation, I cannot find cause for that extension.

VIII. Conclusion

I will grant Tejeda's and the U.S. trustee's requests to extend the 727 deadline and extend it for both of them through the 60th day after entry of the order. I will deny Tejeda's motion to extend the 523 deadline and the U.S. trustee's motion to extend the 707(b) deadline.

I will enter a separate order.

All Citations

Slip Copy, 2022 WL 4652022

Footnotes

1 This disposition is specific to this action. It may be cited for whatever persuasive value it may have.

2 ECF No. 16.

3 ECF No. 19.

4 ECF No. 32 at 2 ¶ 4, Ex. A at 5; ECF No. 45 at 2 ¶ 3 (conveyance deed was from Sours and Timothy); ECF No. 51.

5 ECF No. 32 at 2 ¶ 4, Ex. A at 5.

6 ECF No. 15 items 2 and 18; ECF No. 32 at 2 ¶ 4, Ex. A at 5.

7 ECF No. 32 at 3 ¶ 6.

8 ECF No. 1.

9 ECF No. 1 at 6, item 16a.; ECF No. 4 at 1, item 1.

10 ECF No. 1 at PDF 2 item 5.

11 ECF No. 1 at PDF 13 item 1.

12 ECF No. 1 at PDF 18–19 item 2.

13 ECF No. 1 at PDF 34 item 2.

14 ECF No. 1 at PDF 38 item 18.

15 ECF No. 7.

16 ECF No. 45 ¶ 6.

17 ECF No. 32 at 2 ¶ 4, Ex. A at 4–5; ECF No. 48 at 2 ¶ 4, Ex. A at 4–5.

18 ECF No. 32 ¶ 8, Ex. B at 1.

19 ECF No. 45 at 2 ¶ 3, Ex. 1 at 1–2.

20 ECF No. 45 ¶ 3.

21 ECF No. 45 ¶ 7.

22 ECF No. 45 ¶ 8.

23 ECF No. 45 ¶ 9.

24 ECF No. 45 ¶ 10.

25 ECF No. 17.

26 ECF No. 13.

27 ECF No. 32 ¶ 4.

28 ECF No. 32 Ex. A at 3.

29 ECF No. 32 Ex. A at 2.

30 ECF No. 14.

31 ECF No. 15 items 2 and 18.

32 ECF No. 17.

33 ECF No. 33.

34 Adversary Proceeding No. 22-03008 ECF No. 4.

35 Adversary Proceeding No. 22-03008 ECF No. 27 at 4 ¶ 17–18.

36 Adversary Proceeding No. 22-03008 ECF No. 27 at 5 ¶¶ 19, 27–32.

37 ECF Nos. 16, 19.

38 ECF No. 19 ¶ 4.

39 ECF No. 19 ¶ 5.

40 ECF No. 16 at 2–3 ¶ 8.

41 ECF No. 16 ¶¶ 9, 11.

42 ECF No. 16 at 2.

43 ECF No. 29.

44 ECF No. 32.

45 ECF No. 34.

46 ECF No. 44.

47 ECF Nos. 14, 15.

48 ECF No. 27.

49 ECF No. 48 ¶ 5.

50 ECF No. 48 ¶ 5.

51 ECF Nos. 45, 46.

52 ECF No. 45 at 2, ¶ 4.

53 ECF No. 30

54 ECF No. 45 at 3 ¶ 14.

55 ECF No. 45 at 3-4 ¶ 15.

56 ECF No. 45 at 4 ¶ 16.

57 ECF No. 61.

58 Section 727(a)(2)(A).

59 Section 727(a)(4)(A).

60 Section 727(c)(1).

61 Fed. R. Bankr. P. 7001(4).

62 See sections 523, 524.

63 Section 727(c)(1).

64 *In re* Bomarito, 448 B.R. at 248.

65 Kontrick v. Ryan, 540 U.S. 443, 448 n.3 (2004); *In re* Santos, 112 B.R. 1001, 1004 n.2 (9th Cir. B.A.P. 1990).

66 723 F.3d 1094 (9th Cir. 2013).

67 *Willms*, 723 F.3d at 1102.

68 *Willms*, 723 F.3d at 1103, citing Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P'ship, 507 U.S. 380, 382 (1993).

69 *Willms*, 723 F.3d at 1100.

70 *Willms*, 723 F.3d at 1104.

71 ECF No. 48 at 4–5 ¶ 12, citing *Willms*, 723 F.3d at 1103 & n.7, citing *Pioneer*, 507 U.S. 380, 382 (1993).

72 *Willms*, 723 F.3d at 1103 n.7.

73 https://www.merriam-webster.com/dictionary/viable.

74 291 B.R. 302, 305-06 (Bankr. S.D.N.Y. 2003). See also *In re* Ballas, 342 B.R. 853 (Bankr. M.D. Fla. 2005), aff'd, 212 Fed. App'x. 867 (11th Cir. 2006); *In re* Stonham, 317 B.R. 544, 547 n.1 (Bankr. D. Colo. 2004).

75 See *In re* Stonham, 317 B.R. 544, 547 (Bankr. D. Colo. 2004) (application of excusable neglect to Rule 4007(c) "is improper").

76 *Pioneer*, 507 U.S. at 389 n.4 (emphasis in original).

77 *In re* Magnacom Wireless, LLC, 503 F.3d 984, 993-94 (9th Cir. 2007), citing United States v. Johnson, 256 F.3d 895, 915 (9th Cir. 2001).

78 Barapind v. Enomoto, 400 F.3d 744, 750-51 (9th Cir. 2005), citing Cetacean Cmty. v. Bush, 386 F.3d 1169, 1173 (9th Cir. 2004); Miranda B. v. Kitzhaber, 328 F.3d 1181, 1186 (9th Cir.2003) (per curiam); United States v. Johnson, 256 F.3d 895, 914–16 (9th Cir.2001) (en banc) (Kozinski, concurring).

79 ECF Nos. 46 at 1, 48 ¶ 12.

80 No. NV-19-1157-GLB, 2020 WL 3071975, at *1 (9th Cir. B.A.P. June 5, 2020).

81 Atl. Cleaners & Dyers, Inc. v. United States, 286 U.S. 427, 433 (1932).

82 See *In re* Bomarito, 448 B.R. 242, 248 (Bankr. E.D. Cl. 2011).

83 ECF No. 1 at PDF 11.

84 Proofs of claim 1-1, 2-1, 3-1, 4-1.

85 *Pioneer*, 507 U.S. at 397.

86 ECF No. 48 at 3 ¶ 7.

87 ECF No. 48 at 4 ¶ 9.

TAB 31

Vyas v. Polsinelli PC, Case No. 8:22-CV-71-VMC-CPT (M.D. Fla.) 2022 WL 156805

2022 WL 1568405
Only the Westlaw citation is currently available.
United States District Court, M.D. Florida,
Tampa Division.

Sanket VYAS, as liquidating agent for
and on behalf of Q3I, L.P., Plaintiff,
v.
POLSINELLI PC, and Richard B. Levin, Defendants.

Case No. 8:22-cv-71-VMC-CPT
|
Signed 05/18/2022

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ORDER

VIRGINIA M. HERNANDEZ COVINGTON, UNITED STATES DISTRICT JUDGE

***1** This matter is before the Court on consideration of the Motion to Dismiss filed by Defendants Polsinelli PC and Richard B. Levin (Doc. # 40), filed on April 4, 2022. Plaintiff Sanket Vyas filed a response in opposition on May 2, 2022. (Doc. # 45). For the reasons described below, the Motion is denied.

I. Background

This case involves a now-defunct cryptocurrency trading club, Q3I, L.P. (Doc. # 37 at ¶ 1). Q3I used an algorithm for cryptocurrency trading created by a man named Michael Ackerman. (Id. at ¶ 17). Although Ackerman represented that his algorithm was "wildly successful," in actuality it did not result in the returns he advertised. (Id. at ¶¶ 17, 20). According to the amended complaint, Ackerman defrauded Q3I by reporting false returns in the cryptocurrency exchange accounts and then using those false returns to take "profits" from Q3I pursuant to a profit participation agreement. (Id. at ¶¶ 2, 4). Due to Ackerman's fraud, Q3I lost nearly all of the $35 million the limited partners paid into the club. (Id. at ¶ 2). Plaintiff Vyas is the liquidating agent for Q3I. (Id. at 1).

Vyas alleges that Defendant Levin was an attorney at the law firm of Defendant Polsinelli when he was hired in 2019 to "provide legal advice to Q3I to benefit and protect Q3I." (Id. at ¶ 6). At the time, Levin was the chairman of the firm's FinTech and Regulatory Practice, and Polsinelli promoted Levin as widely recognized for his expertise in the fields of digital currency and blockchain technology. (Id. at ¶¶ 25, 26).

After Levin and Polsinelli were retained, a bank involved with Q3I began to question some of the withdrawals being made, so Q3I's Fund Administrator, Denis McEvoy, asked Levin to provide an opinion "concerning Q3I's position regarding the propriety of the way in which [a] fiduciary account was being handled." (Id. at ¶ 34). Levin and Polsinelli allegedly informed McEvoy that they were "entirely comfortable" with the transfers and the way the accounts were being handled. (Id. at ¶ 35).

According to Vyas, "[t]he only way the transfers [from the fiduciary account] might not have been harmful to Q3I was if Ackerman's reported trading returns were accurate. Yet, Levin prepared Q3I's opinion without verifying the accuracy of Ackerman's reported returns." (Id. at ¶ 7). Vyas alleges that had Levin and Polsinelli performed the required due diligence, they would have "easily" discovered Ackerman's false representations. (Id. at ¶ 8).

Based on these allegations, Vyas brings claims of professional negligence (Count I), negligent misrepresentation (Count II), and breach of fiduciary duty (Count III) against both Levin and Polsinelli. (Id. at 10-16). On April 4, 2022, Polsinelli and Levin filed the instant Motion to Dismiss the amended complaint. (Doc. # 40). Vyas has responded (Doc. # 45), and the Motion is ripe for review.

II. Legal Standard

On a motion to dismiss pursuant to Rule 12(b)(6), this Court accepts as true all the allegations in the complaint and construes them in the light most favorable to the plaintiff. Jackson v. Bellsouth Telecomms., 372 F.3d 1250, 1262 (11th Cir. 2004). Further, the Court favors the plaintiff with all reasonable inferences from the allegations in the complaint. Stephens v. Dep't of Health & Human Servs., 901 F.2d 1571, 1573 (11th Cir. 1990). But,

> ***2** [w]hile a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, a plaintiff's obligation to provide the grounds of his entitlement to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do. Factual allegations must be enough to raise a right to relief above the speculative level.

Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007)(internal citations omitted). Courts are not "bound to accept as true a legal conclusion couched as a factual allegation." Papasan v. Allain, 478 U.S. 265, 286 (1986). The Court must limit its consideration to well-pleaded factual allegations, documents central to or referenced in the complaint, and matters judicially noticed. La Grasta v. First Union Sec., Inc., 358 F.3d 840, 845 (11th Cir. 2004).

III. Analysis

A. *In Pari Delicto* Doctrine

Defendants argue that the *in pari delicto* doctrine bars this action. (Doc. # 40 at 3, 7-11). Under Florida law, the doctrine of *in pari delicto* operates to bar legal remedies where both parties are equally in the wrong or where the plaintiff's wrongdoing exceeds the defendant's wrongdoing. O'Halloran v. PricewaterhouseCoopers LLP, 969 So. 2d 1039, 1041 (Fla. 2d DCA 2007); Turner v. Anderson, 704 So. 2d 748, 751 (4th DCA 1998). In other words, "to assert an *in pari delicto* defense, a defendant must show that the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress." Bailey v. TitleMax of Ga., Inc., 776 F.3d 797, 802 (11th Cir. 2015) (citation and quotation marks omitted). It is an equitable doctrine that precludes a plaintiff who has participated in wrongdoing from recovering damages resulting from that wrongdoing. Off. Comm. of Unsecured Creditors of PSA, Inc. v. Edwards, 437 F.3d 1145, 1152 (11th Cir. 2006).

Although the doctrine is an affirmative defense, affirmative defenses may be raised in a motion to dismiss under Rule 12(b)(6) so long as the defense clearly appears on the face of the complaint. See Quiller v. Barclays Am./Credit, Inc., 727 F.2d 1067, 1069 (11th Cir. 1984) ("Generally, the existence of an affirmative defense will not support a motion to dismiss, [but] a complaint may be dismissed under Rule 12(b)(6) when its own allegations indicate the existence of an affirmative defense, so long as the defense clearly appears on the face of the complaint.").

According to the amended complaint here, Q3I Holdings, LLC, was the general partner of Q3I and was entitled to a 50% profit share from the club's trades. (Doc. # 37 at ¶ 22). And Ackerman was entitled to 33% of Q3I Holdings' share. (Id.). Ackerman allegedly used his trumped-up returns to "dupe" Q3I Holdings into effectuating a transfer of what it believed to be 50% of the profits to Q3I Holdings, and from there Ackerman would take his cut. (Id. at ¶ 23).

Defendants argue that Q3I Holdings, the sole general partner of Q3I, committed the fraud but that the amended complaint improperly paints the fraud as belonging entirely to Ackerman. (Doc. # 40 at 5). Thus, because Q3I Holdings was itself involved in the fraud, and because Vyas, as the liquidating agent, is the successor-in-interest to Q3I Holdings, he cannot recover under the doctrine of *in pari delicto*. (Id. at 2, 5, 7). In Defendants' view, because Vyas stands in the shoes of the general partner who committed the fraud at issue here, he cannot recover. What's more, Defendants argue that because Q3I Holdings held full authority over all operations of Q3I and received half of the fraudulent profits, the "sole actor" exception does not apply. [1] (Id. at 11).

***3** Defendants' argument fails. Here, the amended complaint alleges that Ackerman acted alone in victimizing Q3I "and its general partner" and that Ackerman "duped" the general partner into requesting its profits share so that Ackerman might benefit. (Doc. # 37 at ¶¶ 3, 23). While Defendants dispute whether Q3I Holdings was an innocent victim, the Court must take Vyas's allegations as true at this stage of the proceedings. Thus, the *in pari delicto* defense is not apparent from the face of the complaint. And even assuming (without deciding) that Vyas is standing in the shoes of Q3I Holdings, applying the affirmative defense at this stage would require the Court to make factual determinations as to the relative fault of the parties, which is inappropriate at the motion to dismiss stage. See Moecker v. Bank of Am., N.A., No. 8:13-cv-1095-SCB-EAJ, 2013 WL 12159056, at

*6 (M.D. Fla. Oct. 21, 2013) (rejecting *in pari delicto* defense as premature at the motion-to-dismiss stage given the factual nature of weighing each party's relative guilt).

For this reason, multiple courts in this District have rejected the *in pari delicto* defense as premature at the motion-to-dismiss stage. See Id.; Pennington v. CGH Techs., Inc., No. 6:19-cv-2056-PGB-EJK, 2021 WL 1053159, at *5 (M.D. Fla. Feb. 12, 2021), report and recommendation adopted, 2021 WL 1053275 (M.D. Fla. Mar. 2, 2021); Fed. Deposit Ins. Corp. for Orion Bank of Naples, Fla. v. Nason Yeager Gerson White & Lioce, P.A., No. 2:13-cv-208, 2013 WL 12200968, at *9 (M.D. Fla. July 22, 2013). The more typical practice in this Circuit is to consider affirmative defenses on summary judgment. Fed. Deposit Ins. Corp., 2013 WL 12200968, at *8.

Thus, because the *in pari delicto* defense is not clearly apparent from the face of the complaint, Defendants' Motion must be denied on this point. See Moecker, 2013 WL 12159056, at *6; Sallah v. Fahrenheit Venture Fund LLC, No. 14-22150-CIV, 2014 WL 12629450, at *8 (S.D. Fla. Sept. 5, 2014) (rejecting application of the defense at the motion-to-dismiss stage because "to the extent the parties dispute the existence of innocent management, shareholders, and investors, these are factual issues"); Wiand v. EFG Bank, No. 810-cv-241-EAK-MAP, 2012 WL 750447, at *6 (M.D. Fla. Feb. 8, 2012), report and recommendation adopted, 2012 WL 760305 (M.D. Fla. Mar. 7, 2012) (finding that application of the defense would require the court to wade into factual inquiries that are not appropriately considered on a motion to dismiss and so, "confining its analysis to the allegations in the complaint," the defense was not apparent from the face of the complaint).

B. Negligent Misrepresentation Pleading

Defendants argue that the negligent misrepresentation claim does not meet Rule 9(b)'s heightened pleading standard. (Doc. # 40 at 14-17); see Linville v. Ginn Real Est. Co., LLC, 697 F. Supp. 2d 1302, 1306 (M.D. Fla. 2010) ("Rule 9(b) applies to claims for negligent misrepresentation under Florida law because negligent misrepresentation 'sounds in fraud.' " (citation omitted)).

Vyas does not dispute this general rule but points out that courts will "relax" Rule 9(b)'s requirements for receivers or trustees, who are third-party outsiders with only second-hand knowledge of the fraudulent acts. (Doc. # 45 at 16-17); see Wiand, 2012 WL 750447, at *6 ("Courts relax Rule 9(b)'s heightened pleading requirement for plaintiffs who are trustees or receivers who are third party outsiders to the fraudulent transactions with only second-hand knowledge of the fraudulent acts." (citation and quotation marks omitted)).

Vyas alleges that he has been appointed the liquidating agent for Q3I "to wind up Q3I's affairs and marshal and liquidate its assets for and on Q3I's behalf" pursuant to Delaware law. (Doc. # 37 at ¶ 11). The Delaware provision cited by Vyas provides that persons winding up a limited partnership's affairs may "in the name of, and for and on behalf of, the limited partnership, prosecute and defend suits" in order to marshal and distribute assets. Del. Code tit. 6, § 17-803(b). Given this directive, the Court agrees that Vyas, as a liquidating agent, should be given the benefit of this "relaxed" version of the Rule because he is performing a similar role to that of a receiver or trustee and has similar second-hand knowledge of the particulars of the fraud. In such circumstances, "Rule 9(b)'s particularity requirement is met if the person charged with fraud will have a reasonable opportunity to answer the complaint and has adequate information to frame a response ... or if it identifies the circumstances constituting fraud so that the defendant can prepare an adequate answer from the allegations." In re Palm Beach Fin. Partners, L.P., 517 B.R. 310, 322 (Bankr. S.D. Fla. 2013) (internal quotation marks omitted).

***4** Here, the negligent misrepresentation claim rests on two bases: (1) Levin and Polsinelli's representation to the Fund Administrator, McEvoy, that they were "completely comfortable" with the way the fiduciary account was being handled; and (2) the underlying "implicit" representation that they had reviewed the relevant information and had sufficient knowledge to underpin their opinion. (Doc. # 37 at ¶¶ 61-67). Under the facts of this case, the allegations sufficiently allege the circumstances constituting the fraud – who said what to whom and about what subject matter – and provide Defendants with sufficient information to frame an answer.

Finally, Defendants argue that Levin's "opinion" cannot form the basis for a misrepresentation claim. (Doc. # 40 at 16-17). Vyas counters that the actionable misrepresentation is Levin's implied statement that he reviewed the accounts and governing documents as part of his due diligence, and while he is not alleging "that Levin's opinion was misrepresented to Q3I, he alleges that the facts relating to Levin's diligence in forming that opinion were misrepresented to Q3I." (Doc. # 45 at 17, 18). While this distinction could have been more

clearly drawn in the amended complaint, Vyas did allege that part of his claim is based on Levin's implicit representation that he had performed the required due diligence to draw an informed and educated opinion on the relevant issue. This is sufficient to satisfy Rule 8.

What's more, determining whether a representation is a fact or an opinion requires consideration of all the surrounding circumstances. See Grimes v. Lottes, 241 So. 3d 892, 895–97 (Fla. 2d DCA 2018). Where the representation can be viewed as coming from a person with superior knowledge, the representation should be treated as a fact. Id. To the extent it is unclear whether Levin's ultimate statement about being "completely comfortable" with the accounts was a fact or an opinion, the record is insufficiently developed at this time to make this determination. Defendants' Motion is denied on this ground as well.

Accordingly, it is now

ORDERED, **ADJUDGED**, and **DECREED**:

(1) The Motion to Dismiss filed by Defendants Polsinelli, PC and Richard B. Levin (Doc. # 40) is **DENIED.**

(2) Defendants' answer to the amended complaint is due 14 days from the date of this Order.

DONE and **ORDERED** in Chambers in Tampa, Florida, this 18th day of May, 2022.

All Citations

Slip Copy, 2022 WL 1568405

Footnotes

1 There exists an "adverse interest" exception to the *in pari delicto* defense when the corporation's agent is acting adversely to the interests of the principal. In re Fuzion Techs. Grp., Inc., 332 B.R. 225, 231 (Bankr. S.D. Fla. 2005). But the "sole actor exception" to the adverse interest exception – the exception to the exception — may nevertheless allow an agent's wrongdoing to be imputed to a principal when the agent is the sole representative of the principal. Id. The Court need not determine whether this "exception to the exception" applies because, for the reasons stated herein, the assertion of the defense at this stage of the litigation is premature.

End of Document

TAB 32

In re Tezos Sec. Litig., Case No. 17-CV-06779-RS, (N.D. Cal.) 2018 WL 4293341

2018 WL 4293341
United States District Court, N.D. California.

IN RE TEZOS SECURITIES LITIGATION
This Document Relates to: All Actions

Case No. 17-cv-06779-RS
|
Signed 08/07/2018

ORDER ON DEFENDANTS' MOTIONS TO DISMISS

RICHARD SEEBORG, United States District Judge

I. INTRODUCTION

***1** This putative class action attempts to hold a cryptocurrency enterprise liable for violations of federal securities law. In July 2017, the Tezos blockchain project ("Tezos") conducted an online fundraising effort. Soon thereafter, certain Tezos contributors brought suit against various project participants for the sale of unregistered securities. These cases were consolidated, and Lead Plaintiff Arman Anvari subsequently filed a complaint on behalf of all contributors against four distinct groups of defendants: Arthur Breitman, Kathleen Breitman, and their company Dynamic Ledger Solutions (collectively, "DLS" or "DLS Defendants"), Timothy Draper and certain of his venture capital vehicles (collectively, "Draper"), the Tezos Foundation ("the Foundation"), and Bitcoin Suisse AG ("Bitcoin Suisse"). In separate motions, comprised of overlapping statutory and jurisdictional arguments, the defendants now seek to dismiss the claims against them under Federal Rules of Civil Procedure 12(b)(2) and 12(b)(6). For the reasons set forth below, the motions by DLS and the Tezos Foundation are denied; the motion by Bitcoin Suisse is granted without leave to amend; and the motion by Draper is granted with leave to amend.

II. BACKGROUND [1]

The Breitmans, a husband and wife team based in Northern California, originally conceived of the Tezos project. In 2014, Mr. Breitman released a white paper touting Tezos as "a solution" to the shortcomings of predominant digital currencies such as Bitcoin and Ethereum. *Tezos: A Self-Amending Crypto-Ledger*, (Aug. 3, 2014), https://tezos.com/static/papers/position_paper.pdf. "Tezos," the white paper declared, "truly aims to be the *last* cryptocurrency." *Id.* The following year, the Breitmans formed DLS to hold all Tezos-related intellectual property. At all relevant times, DLS listed Mrs. Breitman as its Chief Executive Officer, Mr. Breitman as its Chief Technology Officer, and the couple's home as its corporate headquarters.

As early as June 2016, the Breitmans began posting on popular internet forums about their plan for a 2017 "crowdsale" in support of Tezos' ongoing operations. Careful, in most instances [2], to avoid characterizing the plan as an "Initial Coin Offering" ("ICO"), these posts nevertheless described a process by which Tezos "tokens" would be allocated in exchange for "initial investment[s]." In a thread for digital currency traders, Mrs. Breitman disclosed that "a small amount of tokens" had already been sold "at a discount ... to a small group of high net worth people and hedge funds." Even as the project came to encompass legally distinct development and fundraising arms, the couple continued to refer to it with the first-person "we."

***2** In May 2017, a *Reuters* article revealed that venture capitalist Timothy Draper had taken a minority position [3] in DLS through his firm Draper Associates Crypto. A well-known technology investor, Draper brought publicity along with his cash. Describing him as "the first prominent venture capitalist to openly embrace initial coin offerings," the article quoted Draper as "want[ing] to make sure those tokens get promoted." His goal proved self-fulfilling: by summer's end, the *Wall Street Journal* would observe the mere fact of his involvement had "significantly raised Tezos's profile."

Around the same time as Draper's public alignment with Tezos, the project's fundraising efforts started to gather steam. [4] Most notably, the Breitmans and DLS established the Tezos Foundation. Based in Switzerland, the purportedly independent non-profit was intended to oversee the ICO, after which it would acquire DLS and assume full responsibility for the technology's future development. While DLS shareholders, as a part of this handoff, stood to receive 8.5% of all funds raised and 10% of all tokens created, the takeaway for individual contributors was less concrete.

Rather than adopting a direct tokens-for-capital system, the Foundation would reward donators by "recommending" (to the decentralized Tezos user network) they be awarded a commensurate token allocation. This flexibility was asymmetric. Contributors, who were to give in either Bitcoin or Ethereum, could not retract donations once recorded on the blockchain ledger.

For the next two months, DLS and the Foundation prepared for the ICO. The Breitmans continued to engage with the online cryptocurrency community, with Mrs. Breitman depicting herself as the "one woman band" charged with "promoting the protocol" in a scheduled chatroom appearance. The Breitmans also undertook work presumably falling within the Foundation's mandate, including development of the websites[5] and applications underlying the eventual ICO. Indeed, even as the Foundation made outwardly autonomous gestures—creating a board of directors, hiring an American spokesperson (Ross Kenyon), and disseminating that spokesperson's "how-to" video for prospective ICO participants—the Breitmans' close advisory role drew its independence into question. That fall, one of the Foundation's original directors would indicate that the Breitmans "control the foundation's domains, websites and email servers, so the foundation has no control or confidentiality in its own communications." *See* Compl. ¶ 48.

The ICO commenced on July 1, 2017, raising the market equivalent of approximately $232 million in Bitcoin and Ethereum[6] by its July 14 close. Nominally overseen by the Foundation, the process bore ample evidence of the Breitmans' handiwork. Three days into the ICO, for instance, Mr. Breitman posted an apology for certain malfunctions, assuring commentators "[w]e're ... cleaning up the mess." Pursuant to a forum-selection clause within "Contribution Terms" drafted by the Foundation, but neither included in nor linked to any of its English-language sites, contributors agreed to Europe as the legal situs of all ICO-related participation and litigation.[7]

***3** Bitcoin Suisse, a foreign firm specializing in the crypto-financial sector, provided intermediary services to certain individual ICO contributors. These services included the conversion of US dollars to Bitcoin and Ethereum, the transfer of that cryptocurrency to the Tezos Foundation, and the creation of digital "wallets" for the later receipt of Tezos tokens. The firm additionally agreed to serve as a co-signatory on all of the Foundation's post-ICO cryptocurrency transactions.

Lead Plaintiff Anvari is an Illinois resident who contributed 250 Ethereum coins to the Tezos ICO. Significantly, he does not allege pre-contribution awareness of any of the defendant-specific promotional or procedural activity recounted above. He does not, in other words, claim to have read the Breitmans' posts, watched the Foundation's how-to video, or been aware of Draper's involvement. Nor, for that matter, does he allege to have engaged in any transactions through Bitcoin Suisse, or to have been ignorant of the purportedly governing Contribution Terms. All the same, he claims he was a victim of an unregistered securities sale, and seeks rescission plus assorted damages for all contributors as against all defendants under Sections 12 and 15 of the Securities Exchange Act of 1934 ("the Exchange Act").

The defendants move to dismiss on the basis of arguments that fall into five general categories: (1) Anvari's failure to establish personal jurisdiction; (2) *forum non conveniens*; (3) the impropriety of the Exchange Act's extraterritorial application; (4) the facial inapplicability of Section 12 "statutory seller" liability on the facts alleged; and (5) the facial inapplicability of Section 15 "control person" liability on the facts alleged.

III. LEGAL STANDARDS

A. Personal Jurisdiction

An action is subject to dismissal if the court lacks personal jurisdiction over the defendants. *See*Fed. R. Civ. P. 12(b)(2). Where there is no federal statute applicable to determine personal jurisdiction, a district court should apply the personal jurisdiction law of the state where the federal court sits. *See* *Schwarzenegger v. Fred Martin Motor Co.*, 374 F.3d 797, 800 (9th Cir. 2004). California law requires only that the exercise of personal jurisdiction comply with federal due process requirements. *See* *id.* at 800-01. Personal jurisdiction over a defendant that does not reside in the forum state may be exercised consistent with due process if the defendant has either a continuous and systematic presence in the state (general jurisdiction), or minimum contacts with the forum state such that the exercise of jurisdiction "does not offend traditional notions of fair play and substantial justice" (specific jurisdiction). *See* *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316 (1946) (citation and internal quotation marks omitted).

B. *Forum Non Conveniens*

District courts have the "inherent power" to decline jurisdiction and to dismiss claims "in exceptional circumstances" under the doctrine of *forum non conveniens*. *Paper Operations Consultants Int'l, Ltd. v. S.S. Hong Kong Amber*, 513 F.2d 667, 670 (9th Cir. 1975). Whether to grant a motion to dismiss or to transfer a case based on the doctrine of *forum non conveniens* lies in the sound discretion of district courts. *SanDisk Corp. v. SK Hynix Inc.*, 84 F. Supp. 3d 1021, 1028 (N.D. Cal. 2015) (citing *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 257 (1981)).

A defendant invoking *forum non conveniens* assumes "the burden of demonstrating an adequate alternative forum, and that the balance of private and public interest factors favors dismissal." *Carijano v. Occidental Petroleum Corp.*, 643 F.3d 1216, 1224 (9th Cir. 2011). The Supreme Court has identified the following private factors: (1) the "relative ease of access to sources of proof"; (2) the "availability of compulsory process for attendance of unwilling" witnesses; (3) "the cost of obtaining attendance of willing[ ] witnesses"; (4) the ability to view the premises if doing so would be appropriate; (5) "all other practical problems that make trial of a case easy, expeditious and inexpensive"; and (6) the "enforceability of a judgment if one is obtained." *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 508 (1947). Public factors include: (1) "administrative difficulties flowing from court congestion"; (2) the "local interest in having localized controversies decided at home"; (3) the desirability of "trial of a diversity case in a forum that is at home with the law that must govern the action"; (4) "the avoidance of unnecessary problems in conflicts of law, or in the application of foreign law"; and (5) the "unfairness" of jury service on a community unrelated to the litigation. *Piper Aircraft*, 454 U.S. at 241 n.6 (internal quotation marks omitted) (citing *Gilbert*, 330 U.S. at 509).

***4** In undertaking its analysis, the court bears in mind that "[a] plaintiff's choice of forum is generally entitled to deference, especially where the plaintiff is a United States citizen or resident, because it is presumed a plaintiff will choose [their] home forum." *Ranza v. Nike,* 793 F.3d 1059, 1076 (9th Cir. 2015) (citation and internal quotation marks omitted). This presumptive deference is "far from absolute." *Id.* at 1076. The more the court's attention is drawn to a plaintiff's "eleventh-hour efforts to strengthen connection with the chosen forum," or other evidence "that the plaintiff's choice of a U.S. forum was motivated by forum-shopping reasons ... the less deference the plaintiff's choice of forum commands." *Ayco Farms, Inc. v. Ochoa*, 862 F.3d 945, 951 (9th Cir. 2017) (citations and internal quotation marks omitted).

C. Failure to State a Claim

"A pleading that states a claim for relief must contain ... a short and plain statement of the claim showing that the pleader is entitled to relief ..." Fed. R. Civ. P. 8(a)(2). "[D]etailed factual allegations" are not required, but a complaint must provide sufficient factual allegations to "state a claim to relief that is plausible on its face." *Ashcroft v. Iqbal,* 556 U.S. 662, 678 (2009) (quoting *Bell Atl. v. Twombly*, 550 U.S. 544, 555, 570 (2007)) (internal quotations marks omitted).

Federal Rule of Civil Procedure 12(b)(6) provides a mechanism to test the legal sufficiency of the averments in a complaint. Dismissal is appropriate when the complaint "fail[s] to state a claim upon which relief can be granted." Fed. R. Civ. P. 12(b)(6). A complaint in whole or in part is subject to dismissal if it lacks a cognizable legal theory or the complaint does not include sufficient facts to support a plausible claim under a cognizable legal theory. *Navarro v. Block*, 250 F.3d 729, 732 (9th Cir. 2001). When evaluating a complaint, the court must accept all its material allegations as true and construe them in the light most favorable to the non-moving party. *Iqbal*, 556 U.S. at 678. Legal conclusions, however, need not be accepted as true and "[t]hreadbare recitals of elements of a cause of action, supported by mere conclusory statements, do not suffice." *Id.* When a plaintiff has failed to state a claim upon which relief can be granted, leave to amend should be granted unless "the complaint could not be saved by any amendment." *Gompper v. VISX, Inc.*, 289 F.3d 893, 898 (9th Cir. 2002) (citation and internal quotation marks omitted).

IV. DISCUSSION

A. Jurisdictional Motions

1. Specific Personal Jurisdiction

As Anvari does not suggest general jurisdiction could attach to either Bitcoin Suisse or the Tezos Foundation, the operative jurisdictional question concerns specific jurisdiction. Such personal jurisdiction can be exercised over a non-resident defendant when three requirements are satisfied: "(1) The nonresident defendant must purposefully direct his activities or consummate some transaction with the forum or resident thereof; or perform some act by which he purposefully avails himself of the privilege of conducting activities in the forum, thereby invoking the benefits and protections of its law; (2) the claim must be one which arises out of or relates to the defendant's forum-related activities; and (3) the exercise of jurisdiction must comport with fair play and substantial justice, i.e. it must be reasonable." *Schwarzenegger*, 374 F.3d at 802 (citation omitted). "The plaintiff bears the burden of satisfying the first two prongs of the test." *Id.* (citation omitted). "If the plaintiff succeeds in satisfying both of the first two prongs, the burden then shifts to the defendant to 'present a compelling case' that the exercise of jurisdiction would not be reasonable." *Id.* (quoting *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476-78 (1985)).

***5** The plaintiff need only make a prima facie showing of jurisdiction to defeat a motion to dismiss, but "may not simply rest on the bare allegations of the complaint." *Ranza*, 793 F.3d at 1068 (internal quotation marks and alterations omitted). "[U]ncontroverted allegations must be taken as true, and conflicts between parties over statements contained in affidavits must be resolved in the plaintiff's favor." *Id.* (internal quotation marks and alterations omitted).

i. *Bitcoin Suisse*

The first requirement of the specific jurisdiction analysis, purposeful direction, is tested under the three-part *Calder* standard. *Schwarzenegger*, 374 F.3d at 803 (citing *Calder v. Jones*, 465 U.S. 783 (1984)). This standard "requires that the defendant allegedly have (1) committed an intentional act, (2) expressly aimed at the forum state, (3) causing harm that the defendant knows is likely to be suffered in the forum state." *Id.* (citations and internal quotation marks omitted). Anvari alleges, in relevant part, that Bitcoin Suisse deliberately contracted with the Foundation in order to facilitate the sale of unregistered securities to United States residents. *See* Compl. ¶ 25 (quoting stated Bitcoin Suisse policy for "US-clients" in the Tezos ICO) (emphasis omitted). A declaration submitted by Bitcoin Suisse's CEO, however, directly contradicts that assertion in insisting the company did *not* provide services for the Tezos ICO to any U.S. investors. Anvari has offered no adequate response to this declaration.

Anvari has further problems with the second prong of the specific jurisdiction test which requires a showing that he would not have been injured "but for" the defendant's forum-related contacts. *See* *Terracom v. Valley Nat'l Bank*, 49 F.3d 555, 561 (9th Cir. 1995). Setting aside Anvari's attempts to cloud this prong's causal focus, his complaint, which does not allege his having in any way known of or utilized Bitcoin Suisse's services, plainly fails to meet this standard. In light of these shortcomings, the exercise of personal jurisdiction over Bitcoin Suisse is improper.

Seeming to anticipate this result, Anvari requests in the alternative to retain Bitcoin Suisse as a "nominal defendant." [8] At oral argument, Anvari's counsel conceded that a plaintiff must show a basis for personal jurisdiction over a nominal defendant just as any other defendant and, as noted above, Anvari has not made such showing. [9] In any event, Bitcoin Suisse does not appear to be a key player in this action. To the extent a future judgment implicates Bitcoin Suisse's role as a co-signatory for the ICO funds, its counsel represented at oral argument that it would comply with all of its obligations under Swiss law. While this promise is not binding, Anvari offers no reason to suspect Bitcoin Suisse will fail to honor it.

For all of the above reasons, the exercise of personal jurisdiction over Bitcoin Suisse is unsupported and amendment appears futile. Anvari's claims against Bitcoin Suisse must therefore be dismissed without leave to amend.

ii. *The Tezos Foundation*

***6** By contrast, the Foundation's relationship to Anvari's alleged harm provides an adequate basis for allowing further factual development of his claims against it. The Foundation is correct that the tezos.com website being (1) hosted on an Arizona server, (2) freely accessible by U.S. citizens, and (3) highly interactive, is not, without more, enough to make it subject to the Court's personal jurisdiction. *See, e.g.,* *Panavision Intern., L.P. v. Toeppen*, 141 F.3d 1316, 1322 (9th Cir. 1998) (collecting Ninth Circuit cases and "agree[ing] ... that posting a website on the Internet is not

sufficient to subject a party to" personal jurisdiction because "there must be 'something more' to demonstrate that the defendant directed his activity towards the forum"); *see also* *Boschetto v. Hansing*, 539 F.3d 1011, 1017-19 (9th Cir. 2011) (finding a "lone transaction for the sale of one item" legally insufficient under a "sliding scale" approach to online purposeful direction analysis). The Foundation errs, however, in clinging to this assertion where, as here, "something more" is in fact alleged.

Bearing in mind the relatively modest jurisdictional showing asked of a plaintiff facing dismissal under 12(b)(2), Anvari's averment that the Foundation kept at least one employee or agent in the United States is responsive to the personal jurisdiction test's first "purposeful direction prong." So too, for that matter, are the following inferences arising from Anvari's allegations: (a) the California-based Breitmans were the de facto U.S. marketing arm of the Foundation; (b) the Foundation engaged in little to no marketing of the ICO anywhere other than in the U.S.; and (c) an accordingly significant portion of the some 30,000 contributors to the ICO were in fact U.S. citizens. A different conclusion might be warranted if Anvari were one of a small number of well-informed Americans who managed to learn about and participate in an ICO exclusively marketed in some foreign country. Here, however, the averments suggest the opposite: the Foundation encouraged U.S. citizens to participate in the ICO, it made it easy for them to do so, and the results reflected those efforts.

Nor is much weight owed to the Foundation's arguments on prong two. Even affording no analytical value to Anvari's allegations concerning its relationship with a U.S. agent or the Breitmans, two of the Foundation's actions nevertheless loom large: the decision to build an English-language, U.S.-hosted website, and the decision to structure an ICO accommodating U.S.-based participation. Irrefutably, these decisions served as "but for" causes of Anvari's alleged unregistered securities purchase. Because the foregoing considerations overwhelm, at this early point in the proceedings, the Foundation's various riffs on the third "reasonableness" prong, Anvari has made a sufficient prima facie personal jurisdictional showing to survive dismissal.

2. *Forum Non Conveniens*

No party meaningfully disputes Switzerland's adequacy in theory as an alternative forum for the adjudication of this matter. Thus, under a traditional *forum non conveniens* inquiry, the only operative issue would be whether Anvari's choice of forum, generally entitled to great deference, should be "disturbed" by a balance of private and public factors weighing "strongly in favor" of the defendants. *Cheng v. Boeing Co.*, 708 F.2d 1406, 1410 (9th Cir. 1983) (citation and internal quotation marks omitted)

Here, the traditional analysis is impacted by the presence of a forum-selection clause. In *Atlantic Marine Construction Co. v. U.S. District Court*, the Supreme Court "redefined the *forum non conveniens* analysis when a valid forum selection clause is present." *In re Orange, S.A.*, 818 F.3d 956, 962 (9th Cir. 2016) (summarizing *Atlantic Marine Const. Co. v. U.S. Dist. Ct.*, 134 S.Ct. 568 (2013)) (italics added). "Because a valid forum selection clause is bargained for by the parties and embodies their expectations as to where disputes will be resolved, it should be given controlling weight in all but the most exceptional cases." *Id.* (citation and internal quotation marks omitted). Among other effects, such a clause precludes a court from "consider[ing] arguments about the parties' private interests." *Id.* (citation and internal quotation marks omitted).

i. *The Tezos Foundation*

***7** Relying principally on *Atlantic Marine*, the Foundation insists the facts of this dispute do not situate it among "the most exceptional cases," thus lending "controlling weight" to the ICO Contribution Terms' selection of Switzerland for all Tezos-related litigation. *Id.* This argument is a strong one, and may well threaten Anvari's access to this forum pending discovery. It is not enough, however, to require dismissal or transfer at this juncture.

"Browsewrap" agreements refer to terms and conditions by which a website attempts to bind its users by inferring affirmative assent. Such agreements are most readily distinguished by comparison to their "clickwrap" counterparts, which ask users specifically to engage with the website—generally by checking a box—in a show of contractual consent. "Where ... there is no evidence that [a] website user had actual knowledge of the agreement, the validity of the browsewrap agreement turns on whether the website puts a reasonably prudent user on inquiry notice of

the terms of the contract." *Nguyen v. Barnes & Noble Inc.*, 763 F.3d 1171, 1177 (9th Cir. 2014).

Here, Anvari outlines a contribution process whereby "a reasonably prudent user" would not have suspected the Contribution Terms' governing force. Cabining his ICO experience to the actual moments of the transaction, he alleges a sequence with only glancing connection to legalese of any sort: on the tenth of a twenty-page document posted to www.tezos.com, the site from which he claims to have been quickly redirected, a single sentence directed users to "refer to the legal document that will be issued by the Foundation for more details." Bereft of hyperlinks to the contract itself, language indicating the user's purported agreement, or other indicia tending to validate a "browsewrap" agreement [10], Anvari's account does not facially indicate his having been put on inquiry notice.

Of course, as the Ninth Circuit has made emphatically clear, evidence of Anvari's "actual knowledge" of the agreement may provide the Foundation with an alternate method of breathing life into the Contribution Terms. *See* *Nguyen*, 763 F.3d at 1176 (opining that "[w]ere there any evidence in the record that [plaintiff] had actual notice of the Terms of Use ... the outcome of this case might be different"); *see also* *Knutson v. Sirius XM Radio Inc.*, 771 F.3d 559, 569 (9th Cir. 2014) (citing *Nguyen*'s inquiry-or-actual notice standard with approval). On this score, Anvari—whose complaint and opposition papers, even where called directly to the question, are conspicuously silent regarding whether he had actual notice [11]—is granted what may ultimately prove to be fleeting procedural mercy. For now, however, the averments in the complaint support an inference that Anvari is not bound by the forum-selection clause.

***8** Consequently, a traditional *forum non conveniens* analysis is in order. Under that framework, the private interest factors set forth in *Gilbert* counsel strongly against dismissal, as the vast majority of evidence, litigants, and assorted practical efficiencies rendering "trial of [this] case easy, expeditious and inexpensive" are most easily accessible in the United States. *Gilbert*, 330 U.S. at 508. There likewise is no denying the "local interest" in having federal securities law enforced at home, this District's crowded dockets and busy jurors notwithstanding. *Piper Aircraft*, 454 U.S. at 241 n.6 (citation omitted). In short, the doctrine of *forum non conveniens* does not presently warrant this action's dismissal or transfer to the courts of Switzerland. Accordingly, the Foundation's *forum non conveniens* motion is denied without prejudice to the Foundation renewing the motion at a later date should doing so be warranted by facts unearthed in discovery.

ii. *DLS*

The Breitmans and DLS both emphasize the Foundation's autonomy and join fully in its *forum non conveniens* argument. Crediting, arguendo, the propriety of extending the benefits of a forum-selection clause to parties seeking explicitly to distance themselves from the underlying contract, this effort suffers from the same defects as the Foundation's. Indeed, without delving into all the relevant private and public factors, it is apparent DLS' status as an American company, run by Americans, in the United States, at the time of this suit's filing, leaves it with an even weaker claim to the operation of the *forum non conveniens* doctrine than its Swiss counterpart. The company's invocation of that doctrine must therefore be rejected.

B. Extraterritorial Application of the Exchange Act

The Foundation, the only defendant alleged to have "sold" a security within the conventional, title-passing sense, predicates its final argument on where such a sale would have necessarily occurred. Citing the "bedrock principle" against extraterritorial application of U.S. law without express Congressional provision, particularly as articulated in *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), the Foundation contends the Exchange Act only regulates domestic transactions. It further reasons any transaction taking place with Anvari could only have occurred in Alderney—a remote outpost of the British Crown specified as the legal site of all ICO transactions by the Contribution Terms. In the event the Contribution Terms' do not govern, the Foundation maintains any ICO-related transfer of title or instance of "irrevocable liability"—both touchstones of the domestic transaction inquiry outlined by the Second Circuit and recently adopted by the Ninth Circuit [12]—is also prospectively confined to Alderney, where the Foundation's "contribution software" resides.

The Foundation, while generally correct as to the scope of federal securities law, misplaces its reliance on the validity of the Contribution Terms. Though likely of consequence at later stages of this action, the Contribution Terms are,

to reiterate, of little significance at this juncture. Focusing instead on the actual (rather than contractual) situs of ICO transactions, the operative question quickly surfaces: where does an unregistered security, purchased on the internet, and recorded "on the blockchain," actually take place?

Try as the Foundation might to argue that all critical aspects of the sale occurred outside of the United States, the realities of the transaction (at least as alleged by Anvari) belie this conclusion. Anvari participated in the transaction from this country. He did so by using an interactive website that was: (a) hosted on a server in Arizona and; (b) run primarily by Arthur Breitman in California. He presumably learned about the ICO and participated in response to marketing that almost exclusively targeted United States residents. Finally, his contribution of Ethereum to the ICO became irrevocable only after it was validated by a network of global "nodes" clustered more densely in the United States than in any other country. While no single one of these factors is dispositive to the analysis, together they support an inference that Anvari's alleged securities purchase occurred inside the United States. [13] Viewed in the light most favorable to Anvari, and proceeding with all due consideration of the limited reach of this nation's laws, application of the Exchange Act does not offend the mandate of *Morrison*.

C. 12(b)(6) Motions

1. Section 12 "Statutory Seller" Liability

***9** Section 12(a)(1) of the Exchange Act prohibits the offer or sale of any unregistered security in interstate commerce. 15 U.S.C. § 77*l*(a)(1). Under the Supreme Court's decision in *Pinter v. Dahl*, Section 12(a)(1) liability "is not limited to persons who pass title" in an unregistered security, but also extends to "the person who successfully solicits the purchase" of such security, "motivated at least in part by a desire to serve his own financial interests or those of the security owner." *Pinter v. Dahl*, 486 U.S. 622, 643-647 (1988). While broad, this latter "statutory seller" theory does not contemplate mere "collateral participants in the ... transaction." *Id.* at 650 n.26. In the Ninth Circuit, *Pinter* liability has been read to require that a defendant be "directly involved in the actual solicitation of a securities purchase." *In re Dauo Systems, Inc.* 411 F.3d 1006, 1029 (9th Cir. 2005) (internal quotation marks omitted); *see also Maine State Ret. Sys. v. Countrywide Fin. Corp.*, 2011 WL 4389689 at *9 (C.D. Cal. May 5, 2011) (permitting Section 12 claims to go forward only where "a direct relationship between the purchaser and the defendant" was sufficiently pled).

i. *Draper*

Draper's argument that he lacked involvement in Anvari's purchasing decision—direct or otherwise—is compelling. As Draper notes, *Pinter*'s "successfully solicits" standard was an express rejection of older, less exacting "substantial factor" tests for § 12(a)(1) statutory seller liability. *See Pinter,* 486 U.S. at 654. Here, Anvari has failed even to allege knowledge of Draper's name, let alone his venture capital activities, prior to participating in the ICO. How, Draper argues, could Anvari have been solicited by a man of whom he was utterly unaware?

His attempts to reframe the issue notwithstanding, Anvari ultimately fails to answer the question. While it may be true the Ninth Circuit stops short of demanding "face-to-face" buyer-seller contact for Section 12 liability to attach, Anvari does not identify any authority, here or elsewhere, holding *Pinter* applicable in the absence of any buyer-seller contact whatsoever. *See, e.g. In re Proxima Corp. Sec. Litig.*, 1994 WL 374306 at *5 (S.D. Cal. 1994). Without averments that he was cognizant of, or influenced by, Draper's involvement in the Tezos project, Anvari's statutory seller claim against Draper is not plausible.

ii. *DLS*

The DLS defendants are less successful in undercutting Anvari's allegations that they successfully solicited his ICO contribution. Conceding a "financial interest" in the ICO generally, DLS nonetheless likens itself to a "collateral participant" in the vein of accountants, lawyers, and other service providers normally situated beyond the scope of statutory seller liability. *Pinter*, 486 U.S. at 647, 650 n.26. By this logic, DLS portrays the Foundation as the only meaningful "seller" in the Tezos universe, reducing its own role to that of a common service provider.

Here, Anvari's rebuttal hits decidedly nearer the mark. Reiterating his factual allegations surrounding DLS' comprehensive involvement with the ICO's planning and

execution, he effectively discredits any notion of DLS as a bit player. More to the point, he frames that involvement—including creation of the Tezos technology, establishment of a legal entity to monetize DLS' interest in that technology, development of a platform to facilitate said monetization, and minute-to-minute oversight of the monetization process itself—as rising well above the level of "collateral participa[tion]" in his and all other ICO transactions. *Pinter*, 486 U.S. at 647. Under *Pinter*'s "statutory seller" standard, Anvari's Section 12 claim therefore withstands DLS' 12(b)(6) motion.

iii. *Bitcoin Suisse*

As noted previously, Anvari has failed to make a colorable showing that the Court has personal jurisdiction over Bitcoin Suisse. Even if he could correct that defect—and this order finds that he cannot—he would remain unable plausibly to state a claim against Bitcoin Suisse under Section 12. The complaint presents the firm's role as that of a "service provider and intermediary ... providing investors with virtual currency conversion services, and then contributing these virtual currencies to the Tezos ICO on behalf of investors." Compl. ¶ 25. Though such averments sufficiently plead Bitcoin Suisse's connection to the ICO, they are not supportive of more than "collateral" involvement. *Pinter*, 486 U.S. at 650 n.26. To the contrary, Anvari's depiction of a "service provider" situates the company squarely within the class of actors "who merely assist in another's solicitation efforts." *Id.* at 651 n.27.

***10** Under *Pinter* and its progeny, such ancillary efforts do not support a defendant's having "successfully solicit[ed]" a securities purchase. *Pinter,* 486 U.S. at 646; *Moore v. Kayport Package Exp.*, 885 F.2d 531, 537 (9th Cir. 1989) (assigning no "role at all in soliciting the purchases" to "defendants [who] performed professional services in their respective capacities"); *Me. State Ret. Sys.*, 2011 WL at *10 (holding "[p]laintiffs must include very specific allegations of solicitation," going beyond a defendant's "being merely a substantial factor in causing the sale of unregistered securities" for Section 12 liability to attach) (internal citations and alterations omitted) (citing *Pinter*, 486 U.S. at 654). Moreover, and placing this considerable shortcoming to the side, Anvari's claim nowhere demonstrates the requisite nexus between his particular transaction and Bitcoin Suisse's "desire to serve [its] own financial interests or those of the security owner." *Pinter*, 486 U.S. at 647. In sum, Anvari's complaint does not support a characterization of Bitcoin Suisse as a "statutory seller" and therefore fails to state a claim under Section 12.

2. Section 15 "Control Person" Liability

Section 15 of the Exchange Act confers secondary liability upon "[e]very person who, by or through stock ownership, agency, or otherwise ... controls any person liable" under Section 12. 15 U.S.C. § 77*o*(a). The Securities and Exchange Commission defines "control" as "the possession, direct or indirect, of the power to direct or cause the direction of ... management and policies." 17 C.F.R. § 230.405. A defendant's "controlling person" status turns chiefly upon "scrutiny of the defendant's participation in the day-to-day affairs of the corporation," as opposed to the "defendant's involvement in an isolated corporate action." [14] *Paracor Finance, Inc.*, 96 F.3d 1151, 1162 (9th Cir. 1996) (citations and internal quotation marks omitted).

i. *Draper*

Draper properly characterizes Anvari's factual allegations as legally insufficient to establish his "control person" status. Muddled though the case-law may be, it is clear the Ninth Circuit requires some assertion of a defendant's "day-to-day" interaction with a company for a Section 15 claim to stand. *See, e.g.* *Kaplan v. Rose,* 49 F.3d 1363, 1382 (9th Cir. 1994) (noting that even "[a] director is not automatically liable as a controlling person" absent evidence of "participation in the [company's] daily affairs"); *SEC v. Todd*, 642 F.3d 1207, 1223 (9th Cir. 2011) (finding "indicia of control [to] include whether the person managed the company on a day-to-day basis") (citations and internal quotations marks omitted). "To ignore the overall situation but to separate out specific actions undertaken by [a defendant] ... would be an unwarranted expansion of secondary liability under the securities law." *Paracor Finance,* 96 F.3d at 1162.

Here, Anvari alleges nothing in the way of Draper's daily or overall participation in the Tezos project or corporate entities. Instead, he asks that his claim move forward on the strength of two facts alone: Draper's minority stake in

DLS, and the temporal proximity of Draper's investment to the Tezos ICO. Admitting the well-settled legal inadequacy of the former to sustain a "control person" claim, Anvari leans heavily on the latter to suggest Draper is a fast-moving puppet master. Fatal to Anvari's suggestion, however, is a fact he pleads elsewhere: that "since at least mid-2016"—a year prior to news of Draper's investment—the Breitmans had been targeting an early 2017 fundraiser. Compl. ¶ 49-51. In other words, even supposing Draper's controlling hand in the "isolated corporate action" of the ICO could support Section 15 liability, that inference is unsupportable on the face of the complaint. Extending Anvari every benefit of the doubt, his argument is simply too threadbare to maintain his claim. Absent further averments regarding Draper's "power to direct or cause the direction of [Tezos'] ... management and policies," as evidenced by his routine interactions with either DLS or the Foundation, Anvari cannot plausibly allege that Draper is liable as a control person. 17 C.F.R. § 230.405.

ii. *DLS*

***11** As noted in the above discussion of Section 12 liability, DLS' role in establishing and aiding the Tezos Foundation rendered the two entities deeply intertwined, if not functionally interchangeable, throughout the ICO process. Further averments, including a former Foundation director's detailed description of the Breitmans' "control" over the Foundation and the Breitmans' regular, expansive use of the word "we," urge a reading of interchangeability on a more general level. While the Breitmans and DLS are free to renew their arguments regarding the detached operation and structure of the Foundation at later stages in this litigation, at this point, Anvari's allegations are sufficient to enable his Section 15 "control person" claim against them to survive dismissal.

V. CONCLUSION

The motions to dismiss filed by the DLS Defendants and the Foundation are denied. The motion filed by Bitcoin Suisse is granted without leave to amend. The motion filed by Draper is granted with leave to amend. Any amended complaint must be filed within 20 days of the issuance of this order.

IT IS SO ORDERED.

All Citations

Not Reported in Fed. Supp., 2018 WL 4293341, Fed. Sec. L. Rep. P 100,262

Footnotes

1 Unless otherwise noted, this synopsis is based on facts drawn from the complaint, which must be taken as true for purposes of a 12(b)(6) motion. For purposes of a 12(b)(2) motion, "uncontroverted allegations must be taken as true, and conflicts between parties over statements contained in affidavits must be resolved in the plaintiff's favor." *Ranza v. Nike, Inc.*, 793 F.3d 1059, 1068 (9th Cir. 2015) (internal quotation marks and alterations omitted).

2 Roughly two months prior to the fundraiser, under the handle "arthurb," a user purporting to represent Tezos alluded to "our ICO" on the website bitcointalk.org. Compl. ¶ 40.

3 While Anvari sets this investment at $1,500,000 in his complaint, Draper disagrees. By his account, Draper Associates Crypto purchased a $500,000, ten percent stake in DLS in May 2017, before separately joining a $1,000,000 capital pool during the July 2017 Tezos fundraiser. In his opposition to this motion, Anvari appears to concede the point.

4 In deference to the language of the complaint, the Tezos fundraiser will hereinafter be referred to as an "ICO."

5 These websites include tezos.ch, crowdfund.tezos.com, and tezos.com, the last of which is hosted on an Arizona server.

6 By December 2017, a surge in the cryptocurrency market left these funds with a value over $1 billion. At current prices, that figure rests nearer to $700 million.

7 "The Contribution Software and the Client are located in Alderney. Consequently, the contribution procedure ... is considered to be executed in Alderney." Contribution Terms ¶ 46. "The applicable law is Swiss law. Any dispute ... shall be exclusively and finally settled in the courts of Zug, Switzerland." *Id.* ¶ 48.

8 "A nominal defendant is a person who holds the subject matter of the litigation in a subordinate or possessory capacity as to which there is no dispute. The paradigmatic nominal defendant is a trustee, agent, or depository who is joined purely as a means of facilitating collection." *SEC v. Colello*, 139 F.3d 674, 676 (9th Cir. 1998) (citations and internal quotation marks omitted).

9 Because Anvari has failed to make a colorable showing, his additional request for jurisdictional discovery is denied.

10 It bears noting that even faced with ample evidence of such hallmarks, browsewrap agreements may still be held unenforceable. *See* *Nguyen*, 763 F.3d at 1178-79 (noting "courts' traditional reluctance to enforce browsewrap agreements against individual consumers," and declining to enforce one "where a website makes its terms of use available via a conspicuous hyperlink on every page ... even in close proximity ... to relevant buttons users must click on").

11 *Compare* Tezos Foundation's Mot. Dismiss at 18 (highlighting that Anvari "has nowhere alleged that he was unaware of the Contribution Terms when he made his contribution"), *with* Pl.'s Opp'n Tezos Foundation's Mot. Dismiss at 16 (declining to so allege, and arguing "it is irrelevant whether Lead Plaintiff or the Class was aware of the Contribution Terms"). Indeed, at oral argument, Anvari's counsel represented that they did not know whether Anvari had actual notice of the terms.

12 *See* *Stoyas v. Toshiba Corp.*, 2018 WL 3431764, at *11 (9th Cir. July 17, 2018) ("a plaintiff must plausibly allege "that the purchaser incurred irrevocable liability within the United States to take and pay for a security, or that the seller incurred irrevocable liability within the United States to deliver a security.") (quoting *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60, at 68 (2d Cir. 2012)).

13 *Cf.* *Securities and Exchange Commission v. Traffic Monsoon, LLC*, 245 F.Supp.3d 1275, 1296 (D. Utah 2017) (holding that where non-exchange listed securities are offered and sold over the internet, the sale takes place in both the location of the seller and the location of the buyer.)

14 There is some dispute amongst the parties as to whether the Ninth Circuit additionally demands a prospective control person's "culpable participation" in the underlying violation. *Compare* Draper's Mot. Dismiss, Dkt. 117 at 9, *with* Pl.'s Opp'n to Draper's Mot. Dismiss, Dkt. 134 at 10. As has been aptly observed in the Second Circuit, "for section 15 claims, *some* California federal courts have held that culpable participation is required." *In re WorldCom, Inc.*, 377 B.R. 77, 104 (Bankr. S.D.N. Y 2007) (emphasis added). Because this issue only stands to impact the Section 15 claim against Draper, which falls for failure to support the more fundamental fact of his "control" over the Tezos project, it need not be resolved here.

TAB 33

Balestra v. Cloud With Me Ltd., Case No. 2:18-CV-00804 (W.D. Pa.) 2020 WL 4368153

2020 WL 4368153
Only the Westlaw citation is currently available.
United States District Court, W.D. Pennsylvania.

Raymond BALESTRA, individually and on behalf of all others similarly situated, Plaintiff,
v.
CLOUD WITH ME LTD., Gilad Somjen, and Asaf Zamir, Defendants.

Civil Action No. 2:18-cv-00804
|
Signed 07/30/2020

Attorneys and Law Firms

Alfred G. Yates, Jr., Law Offices of Alfred G. Yates, Jr., Pittsburgh, PA, Donald J. Enright, Pro Hac Vice, Levi & Korsinsky LLP, Washington, DC, for Plaintiff.

ECF No. 22

ORDER ON PLAINTIFF'S MOTION TO CERTIFY CLASS

Mark R. Hornak, Chief United States District Judge

***1** The Complaint in this securities class action against Defendants Cloud With Me Ltd. ("Cloud" or the "Company"), Gilad Somjen ("Somjen"), and Asaf Zamir ("Zamir") (collectively, "Defendants") was filed on June 19, 2018, and alleges that from July 25, 2017, through June 19, 2018 (the "Class Period"), Defendants offered and sold Plaintiffs and the Class (defined below) unregistered securities—in the form of Cloud Tokens ("CLD Tokens")—in violation of Section 12(a)(1) and 15(a) of the Securities Act of 1933 ("Securities Act") 15 U.S.C. §§ 77*l*(a)(1), 772(a). ECF No. 1. The case was referred to United States Magistrate Judge Lisa Pupo Lenihan for pretrial proceedings in accordance with the Magistrate Judges Act, 28 U.S.C. § 636(b)(1), and Local Rules of Court 72.C and 72.D.

Following repeated attempts to serve Defendants, all of which are located outside of the United States, service was effected on October 18, 2018. ECF No. 10. No response was filed to the Complaint by any of the Defendants and Motions for Default were filed on April 30, 2019. ECF Nos. 11,12,13. These were followed by Requests for Entry of Default, filed on May 1, 2019. ECF Nos. 14, 15, 16.[1] Default against all Defendants was entered by the Clerk on May 3, 2019. ECF Nos. 17, 18, 19. The present Motion to Certify Class, appoint Ray Balestra and John Oum as Class Representatives, and appoint Levi & Korsinsky, LLP as Class Counsel was filed on March 12, 2020. ECF No. 22.

The Magistrate Judge's Report and Recommendation (ECF No. 26) filed on July 2, 2020 recommended that the Motion for Class Certification be granted and each of these three (3) aspects, pursuant to Federal Rule of Civil Procedure 23(a), 23(b)(3), and 23(g). In so recommending, the Magistrate Judge considered and confirmed Plaintiff's satisfaction of each of the applicable requirements of Federal Rule of Civil Procedure 23. The parties were informed that in accordance with the Magistrate Judges Act, 28 U.S.C. § 636(b)(1)(B) and (C), and Rule 72.D.2 of the Local Rules of Court, they had fourteen (14) days to file any objections, and that unregistered ECF users were given an additional three (3) days pursuant to Federal Rule of Civil Procedure 6(d). No objections to the Report have been filed.

Upon independent, *de novo* review of the motions and the record, and upon consideration of the Magistrate Judge's Report and Recommendation (ECF No. 26), which is adopted as the Opinion of this Court:

IT IS ORDERED that Plaintiff's Motion to Certify Class (ECF No. 22) **is GRANTED and** the following class is certified:

> All persons or entities who purchased or otherwise acquired Cloud Tokens ("CLD Tokens") during the period from July 23, 2017 through June 19, 2018, inclusive (the "Class Period"), and were injured thereby. Excluded from the Class are: (i) defendant Cloud; (ii) Defendants Somjen and Zamir; (iii) any person who was an officer, director or employee of Cloud; (iv) any immediate family member of any excluded person; (v) any firm, trust, corporation or other entity in which any excluded person or entity has or had a controlling interest; and

(vi) the legal representatives, affiliates, heirs, successors in-interest, or assigns of any such excluded person or entity.

***2 IT IS FURTHER ORDERED** that Lead Plaintiff John Oum and Raymond Balestra are appointed as representative Plaintiffs for this Class and that the law firm of Levi & Korsinsky, LLP is appointed as counsel for the Class.

IT IS FURTHER ORDERED that the Report and Recommendation (ECF No. 26) of Magistrate Judge Lenihan, dated April 9, 2020, is adopted as the Opinion of the Court.

SO ORDERED.

All Citations

Slip Copy, 2020 WL 4368153

Footnotes

1 The Clerk of Court noted that the Motions were filed under the wrong event on May 1, 2019, prompting the revised filings.

TAB 34

Fabian v. LeMahieu, Case No. 19-CV-00054, (N.D. Cal.) 2020 WL 3402800

2020 WL 3402800

Editor's Note: Additions are indicated by Text and deletions by ~~Text~~ .

Only the Westlaw citation is currently available.

United States District Court, N.D. California.

James FABIAN, Plaintiff,

v.

Colin LEMAHIEU, et al., Defendants.

Case No. 4:19-cv-00054-YGR

|

Signed 06/19/2020

Attorneys and Law Firms

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ORDER: (1) GRANTING MOTION FOR LEAVE TO EFFECT ALTERNATIVE SERVICE; (2) GRANTING IN PART AND DENYING IN PART MOTION TO STRIKE AFFIRMATIVE DEFENSES RAISED IN THE ANSWER; (3) DENYING MOTION TO DISMISS FOR *FORUM NON CONVENIENS*

Re: Dkt. Nos. 81, 84, 85

Yvonne Gonzalez Rogers, United States District Judge

***1** Plaintiff James Fabian brings this putative class action against defendants Nano f/k/a/ RaiBlocks f/k/a Hieusys, LLC ("Nano"), Colin LeMahieu, Mica Busch, Zack Shapiro, and Troy Retzer (collectively, "Nano Defendants") as well as B.G. Services SRL f/k/a BitGrail SRL f/k/a Webcoin Solutions ("BitGrail") and Francesco "The Bomber" Firano (collectively "BitGrail Defendants") [1] for securities fraud and related claims in connection with defendants' promotion of and statements regarding a cryptocurrency or digital asset referred to as NANO f/k/a RaiBlocks ("XRB" or "Nano Tokens"). (Dkt. No. 58 ("FAC") at 1.)

Now before the Court are the following motions: (1) Fabian's motion for leave to effect alternative service (Dkt. No. 81); (2) Fabian's motion to strike affirmative defenses raised in the Nano Defendants' answer (Dkt. No. 84); and (3) the Nano Defendants' motion to dismiss for *forum non conveniens.* (Dkt. No. 85)

Having carefully reviewed the record, the papers submitted on each motion, and for the reasons set forth more fully below, the Court **HEREBY ORDERS** as follows: (1) motion for leave to effect alternative service is **GRANTED**; (2) the motion to strike affirmative defenses raised in Nano Defendants' answer is **GRANTED IN PART** and **DENIED IN PART**; and (3) the motion to dismiss for *forum non conveniens* is **DENIED**.

I. RELEVANT BACKGROUND

In order to expedite the issuance of this Order, the Court incorporates the factual and procedural background from the prior order granting in part and denying in part the motion to dismiss. (Dkt. No. 66 at 2-11.) [1] The Court only summarizes the relevant background since the issuance of the prior order. Thus:

In response to the Court's prior orders, the Nano Defendants filed their answer on October 25, 2019. (Dkt. No. 70.) In the answer, the Nano Defendants raise ten affirmative defenses. (*Id.*)

The Court and the parties conferred for a case management conference on November 18, 2019, where the parties indicated their intention to bring the now pending motions. (Dkt. No. 80.) Upon the completion of the parties' briefing, the Court vacated the motion hearings, (Dkt. Nos. 89, 99) deciding that the motions were appropriate for resolution without oral argument. *See* *Lake at Las Vegas Investors Group, Inc. v. Pacific Malibu Dev. Corp.*, 933 F.2d 724, 729 (9th Cir. 1991).

II. MOTION FOR LEAVE TO EFFECT ALTERNATIVE SERVICE

A. Legal Standard

Rule 4(f)(3) of the Federal Rules of Civil Procedure provides that "an individual ... may be served at a place not within any judicial district of the United States ... by other means not prohibited by international agreement, as the court orders." Fed. R. Civ. P. 4(f)(3). Similarly, Rule 4(h)(2) permits service of a corporation "at a place not within any judicial district of the United States, in any manner prescribed by Rule 4(f) for serving an individual, except personal delivery under (f)(2)(C)(i)." Fed. R. Civ. P. 4(h)(2).

***2** It is left "to the sound discretion of the district court the task of determining when the particularities and necessities of a given case require alternate service of process under Rule 4(f)(3)." *Rio Properties, Inc. v. Rio Int'l Interlink*, 284 F.3d 1007, 1016 (9th Cir. 2002). Service under Rule 4(f)(3) is "neither a last resort nor extraordinary relief." *Id.* at 1015. To the contrary, "court-directed service under Rule 4(f)(3) is as favored as service available under Rule 4(f)(1) or Rule 4(f)(2)" and "the advisory notes indicate the availability of alternate service of process under Rule 4(f)(3) without first attempting service by other means." *Id.* To satisfy constitutional norms of due process, the alternative method of service must be "reasonably calculated, under all the circumstances, to apprise the interested parties of the action and afford them an opportunity to present their objections." *Id.* at 1016. In other words, " 'service under Rule 4(f)(3) must be (1) directed by the court; and (2) not prohibited by international agreement. No other limitations are evident from the text.' " *Id.* at 1014. In applying Rule 4(f)(3), "trial courts have authorized a wide variety of alternative methods of service including publication, ordinary mail, mail to the defendant's last known address, delivery to the defendant's attorney, telex, and most recently, email." *Id.* at 1016 (collecting cases).

B. Analysis

Fabian requests service on the BitGrail Defendants, Firano's counsel, and the BitGrail Defendants' bankruptcy trustee via mail, email, and social media. The Court addresses the three issues raised by Fabian, namely that: (1) service on the BitGrail Defendants' bankruptcy trustee and Firano's counsel in Italy – in addition to service on the BitGrail Defendants themselves – is appropriate; (2) the proposed methods of service – by mail, by electronic mail, and social media – are not prohibited by international agreement; and (3) the proposed methods of alternative service are reasonably calculated to provide the BitGrail Defendants with notice of this action and afford them the opportunity to present their objections to the charges against them. The Nano Defendants filed no response to this motion. The Court addresses each of these three arguments in turn below.

1. Additional Service on the Bankruptcy Trustee and Counsel.

Based on a review of the record, the Court concludes that additional service on the BitGrail's bankruptcy trustee and Firano's counsel in Italy is appropriate in this matter. As the record demonstrates, Firano's counsel in Italy, Francesco Ballati, remains in contact with Firano. (*See generally* Dkt. No. 81-5.) Moreover, Ballati's response – that communications about this action should be sent to the bankruptcy trustee – indicates that service upon the bankruptcy trustee is appropriate. (*Id.*) "[T]rial courts have authorized a wide variety of alternative methods of service including ... delivery to the defendant's attorney." *Rio Props.*, 284 F.3d at 1016. Indeed, "courts around the country have found that service upon a foreign defendant through counsel is appropriate to prevent further delays in litigation." *Knit With v. Knitting Fever*, Inc., No. 08-cv-4221 (RLB), 2010 WL 4977944, at *4 (E.D. Pa. Dec. 7, 2010) (collecting cases).

Thus, service on the BitGrail Defendants by providing the service documents to Ballati and the Bankruptcy Trustees and requesting that the documents be forwarded to Firano is appropriate.

2. Proposed Methods of Service Are Not Prohibited by International Agreement

Here, the Court concludes that service via mail, electronic mail, and social media are appropriate. First, it is well established that service by mail to Italian based parties is appropriate. "Both the Ninth Circuit and California courts have held that Article 10(a) of the Hague Convention allows service of process by mail, so long as the country in which

service is being effected does not object." *Bondanelli v. Ocean Park SRL*, No. CV 12-07724 GAF (SSx), 2013 WL 12139129, at *1 (C.D. Cal. Oct. 7, 2013) (citing *Brockmeyer v. May*, 383 F.3d 798, 801–02 (9th Cir. 2004)). "Italy has not objected" to Article 10(a). *Bondanelli*, 2013 WL 12139129, at *1. Moreover, Italy explicitly permits service of process by mail. *See* United States Department of State, Judicial Assistance Country Information: Italy (last updated Nov. 15, 2013). In light of the foregoing, numerous other courts have found service of process by mail to be accepted in Italy. *See Bondanelli*, 2013 WL 12139129, at *1 (collecting cases).

***3** As to authorization of service in this jurisdiction, "the determination of whether Plaintiff properly served the Summons and Complaint will be made applying the California Code of Civil Procedure." *Id.* at *2. These requirements include mailing via first-class mail or airmail, postage prepaid, requiring or requesting a return receipt. *See* Cal. Code Civ. Proc. § 415.40. Thus, with regard to service by mail, the Court finds that service is not prohibited by international agreement.

Second, with regards to service via electronic mail and social media, courts have found such service not prohibited by international agreement and have approved of such service in the court's discretion. "[T]rial courts have authorized a wide variety of alternative methods of service including ... email." *Rio Properties, Inc.*, 284 F.3d at 1018 (citations omitted). And courts in this district have authorized service of process by social media. *See, e.g., St. Francis Assisi v. Kuwait Fin. House*, No. 3:16-cv-3240 (LB), 2016 WL 5725002, at *2 (N.D. Cal. Sep. 30, 2016) (discussing decision to grant "service by email, Facebook, and LinkedIn because notice through these accounts was reasonably calculated to notify the defendant of the pendency of the action and was not prohibited by international agreement"); *UBS Fin. Servs. v. Berger*, No. 13-cv-03770 (LB), 2014 WL 12643321, at *2 (N.D. Cal. Apr. 24, 2014) (recounting court's decision to authorize service via defendant's "gmail address and through LinkedIn's 'InMail' feature"); *Tatung Co. v. Shu Tze Hsu*, SA CV 13-1743-DOC (ANx), 2015 WL 11089492, at *2 (C.D. Cal. May 18, 2015) ("Courts routinely authorize email service under Rule 4(f)(3)") (citing cases). Here, the Court concludes that neither service method is prohibited by international agreement. Moreover, the Court exercises its discretion to permit such methods of service in this matter. Thus, the court finds that service by email and social media – coupled with service by mail – are appropriate here and are not prohibited by international agreement.

3. Proposed Methods of Service Are Reasonably Calculated to Provide the BitGrail Defendants with Notice of this Action

Finally, the Court concludes that the proposed methods of service are reasonably calculated to provide the BitGrail defendants with notice of this action. Rule 4 is "flexible rule that should be liberally construed so long as a party receives sufficient notice of the complaint." *United Food & Commercial WorkersUnion v. Alpha Beta Co.*, 736 F.2d 1371, 1382 (9th Cir. 1984). Here, in light of the facts that: service is being made personally on Firano, that Ballati confirmed in October 2019 that he continues to represent Firano, that Ballati indicated that documents regarding this action should be forwarded to the bankruptcy trustee, and that service is being made on the BitGrail Defendants via several methods, the Court concludes that, under the circumstances, the methods are reasonably calculated to provide notice to the BitGrail defendants and afford them an opportunity to present their objections.

Accordingly, in light of the foregoing analysis, the Court **GRANTS** the motion for leave to effect alternative service as requested in the motion.

III. MOTION TO STRIKE AFFIRMATIVE DEFENSES RAISED IN THE ANSWER

A. Legal Standards

Rule 12(f) allows a court to strike "redundant, immaterial, impertinent, or scandalous matter" from a pleading. A court may grant a motion to strike where "the matter to be stricken clearly could have no possible bearing on the subject of the litigation." *In re Arris Cable Modem Consumer Litig.*, No. 17-CV-01834-LHK, 2018 WL 288085, at *5 (N.D. Cal. Jan. 4, 2018). The purpose of a Rule 12(f) motion is to "avoid the expenditure of time and money that must arise from litigating spurious issues by dispensing with those issues prior to trial." *Sydney-Vinstein v. A.H. Robins Co.*, 697 F.2d 880, 885 (9th Cir. 1983).

***4** Further, because Rule 12(f) motions are disfavored, "courts often require a showing of prejudice by the moving

party before granting the requested relief." *Sanchez v. City of Fresno*, 914 F. Supp. 2d 1079, 1122 (E.D. Cal. 2012) (quoting *Cal. Dep't of Toxic Substances Control v. Alco Pac., Inc.*, 217 F. Supp. 2d 1028, 1033 (C.D. Cal. 2002)). "If there is any doubt whether the portion to be stricken might bear on an issue in the litigation, the court should deny the motion." *Holmes v. Elec. Document Processing, Inc.*, 966 F. Supp. 2d 925, 930 (N.D. Cal. 2013) (quoting *Platte Anchor Bolt, Inc. v. IHI, Inc.*, 352 F. Supp. 2d 1048, 1057 (N.D. Cal. 2004)). It is within the sound discretion of the district court whether to grant a motion to strike. *See* *Whittlestone, Inc. v. Handi-Craft Co.*, 618 F.3d 970, 973 (9th Cir. 2010) (citing *Nurse v. United States*, 226 F.3d 996, 1000 (9th Cir. 2000)).

"The key to determining the sufficiency of pleading an affirmative defense is whether it gives plaintiff fair notice of the defense." *G & G Closed Circuit Events, LLC v. Nguyen*, No. 10-CV-00168-LHK, 2010 WL 3749284, at *1 (N.D. Cal. Sept. 23, 2010) (quoting *Wyshak v. City Nat. Bank*, 607 F.2d 824, 827 (9th Cir. 1979)). "What constitutes fair notice depends on the particular defense in question." *G &G*, 2010 WL 3749284, at *1 (quoting 5C Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 1381, at 410 (3d ed.2004)). "While a defense need not include extensive factual allegations in order to give fair notice ... bare statements reciting mere legal conclusions may not be sufficient." *G &G*, 2010 WL 3749284, at *1 (internal citations omitted). "Because motions to strike a defense as insufficient are disfavored, they 'will not be granted if the insufficiency of the defense is not clearly apparent.' " *Id.* (quoting 5C Wright & Miller § 1381, at 428).

B. Analysis

Fabian moves to strike ***all*** of the affirmative defenses raised in the Nano Defendants' answer, including the reservation to add further affirmative defenses. Given the breadth of the motion, the Court considered sanctioning Fabian for the filing of a frivolous motion which did not meet the basic standards of such a disfavored motion. Not surprisingly, the Nano Defendants oppose the request to strike the defenses. Fabian is **hereby warned** that the Court will deal with any such similar filings in the future summarily and **may *sua sponte*** inquire on the appropriateness of **sanctions**. Counsel should know better than to overburden courts without cause. All of this could have been easily accomplished through written discovery. Similarly, the Nano Defendants should not haphazardly include affirmative defenses without a legitimate legal basis.

The Court addresses each ground in turn below. Thus:

First Affirmative Defense: Failure to State a Claim. **GRANTED**. "Failure to state a claim is not a proper affirmative defense but, rather, asserts a defect in [plaintiff's] prima facie case." *Barnes v. AT&T Pension Ben. Plan-Nonbargained Program*, 718 F. Supp. 2d 1167, 1174 (N.D. Cal. 2010). *See also id.* ("[D]espite its inclusion in Civil Form 30, failure to state a claim under Rule 12(b)(6) is more properly brought as a motion and not an affirmative defense."); *G &G*, 2010 WL 3749284, at *1 ("The following affirmative defenses are merely denials of the allegations and claims set forth in the Complaint: ... failure to state a claim[.]"). Moreover, the Court notes that it has now dealt with two prior motions to dismiss from the Nano Defendants and have addressed similar arguments regarding Fabian's failure to state a claim. (*See* Dkt. Nos. 56, 66.) Thus, this affirmative defense is appropriately stricken but was quite unnecessary for purposes of a motion.

***5** Second Affirmative Defense: Contributory Negligence/ Comparative Fault. **DENIED**. At this stage, prior to discovery, such a defense is appropriately maintained. This is so where the Court has made no formal holding as the choice of law in this class action.[2] Moreover, the Court concludes that while the factual details in the answer are scant, such details are sufficient where the lack of greater detail can be remedied through the formal discovery process. *See* *Figueroa v. Baja Fresh Westlake Vill., Inc.*, No. 12-cv-769-GHK-SPX, 2012 WL 2373254, at *2 (C.D. Cal. May 24, 2012) ("[P]laintiff's Motion is DENIED inasmuch as it relies on the factual insufficiency of the defenses asserted."); *see also* *Diaz v. Alternative Recovery Mgmt.*, No. 12-cv-1742-MMA-BGS, 2013 WL 1942198, at *2 (S.D. Cal. May 8, 2013) ("Any lack of factual detail in these defenses may be remedied through the formal discovery process, as is done in the vast majority of cases."). Thus, the Court declines to strike this affirmative defense.

Third Affirmative Defense: Failure to Mitigate. **DENIED**. Courts routinely permit parties to plead a failure to mitigate defense without specific factual allegations prior to the

conclusion of discovery. *See Bd. Of Trs. Of San Diego Elec. Pension Trust v. Bigley, Elec., Inc.*, No. 07–cv–634–IEG (LSP), 2007 WL 2070355, at *3 (S.D. Cal. July 12, 2007) (collecting cases) ("A handful of courts have been confronted with the issue of whether a defendant's mere allegation that 'plaintiff failed to mitigate damages' is sufficient under the pleading requirements of Rule 8. These courts have typically held that a generalized statement, such as the one used in the instant case, meets defendant's pleading burden with respect to the affirmative defense of damage mitigation."); *accord Nomadix, Inc. v. Guest-Tek Interactive Entm't LTD.*, No. 2:16-CV-08033, 2017 WL 7275391, at *7 (C.D. Cal. Nov. 30, 2017); *Horton v. NeoStrata Co. Inc.*, No. 3:16-cv-02189-AJB-JLB, 2017 WL 2721977, at *12 (S.D. Cal. June 22, 2017) ("The Court finds that this same analysis applies.... Thus, as the discovery cut-off date is set for February 6, 2018, the Court cannot say at this juncture that other facts may not come to light later down the road. Thus, Plaintiffs' motion to strike 24 Seven Defendants' sixth [unclean hands], eighteenth [failure to mitigate], nineteenth [contribution by Plaintiffs' own acts], and twenty-first [willfulness] affirmative defenses is DENIED."); *Lexington Ins. Co. v. Energetic Lath & Plaster, Inc.*, No. 2:15-cv-00861-KJM, 2015 WL 5436784, at *13 (E.D. Cal. Sept. 15, 2015); *Ganley v. Cty. of San Mateo*, No. 3:06-CV-03923, 2007 WL 902551, at *6 (N.D. Cal. Mar. 22, 2007) ("Although no case law from this district or circuit is available, several courts have held that 'where discovery has barely begun, the failure to mitigate defense is sufficiently pled without additional facts.' .... This reasoning is persuasive here because discovery has just begun, Plaintiff has been put on notice of the defense, and the possibility remains that additional facts may be alleged that would support the affirmative defense of mitigation. Therefore, the defense may be supported by additional, as of yet undiscovered facts, and will not be stricken."). Thus, the Court declines to strike this affirmative defense.

Fourth Affirmative Defense: Assumption of Risks. **DENIED**. While the Court concluded that Fabian alleged sufficient facts to state a claim, including that the Nano Defendants owed a duty to Fabian, there has been no merits determination on this issue. Fabian otherwise provides no basis for the striking of this affirmative defense. Thus, the Court declines to strike this affirmative defense.

***6** Fifth Affirmative Defense: Set-Off. **DENIED**. Although the allegations in the answer are bare, the Court finds that they sufficiently plead sufficient facts as to any "set-off" affirmative defense. Thus, the Court declines to strike this affirmative defense.

Sixth Affirmative Defense: Apportionment. **DENIED**. As the Nano Defendants point out, courts in this district note that apportionment is applicable in negligence and intentional tort actions. *See Izett v. Crown Asset Mgmt., LLC*, No. 18-cv-05224-EMC, 2018 WL 6592442, at *3 (N.D. Cal. Dec. 14, 2018) ("Courts have held that affirmative defenses like apportionment and equitable indemnity 'while applicable in negligence and intentional tort actions, have no relation to ... FDCPA or RFDCPA claims' like those asserted in Plaintiff's complaint."); *Perez v. Gordon & Wong Law Grp., P.C.*, No. 11-cv-03323-LHK, 2012 WL 1029425, at *11 (N.D. Cal. Mar. 26, 2012) ("Finally, the Court concludes that Defendants' ninth (apportionment) and eleventh (equitable indemnity) affirmative defenses, while applicable in negligence and intentional tort actions, have no relation to the FDCPA or RFDCPA claims asserted in Plaintiff's Complaint."). Thus, the Court declines to strike this affirmative defense.

Seventh Affirmative Defense: Current Law Prohibits Plaintiff's Claims. **GRANTED**. This affirmative defense appears to be another way of stating that Fabian has failed to state a claim. *See, e.g., Minns v. Advanced Clinical Emp't Staffing, LLC.*, No. 13–cv–03249–SI, 2014 WL 5826984, at *3 (N.D. Cal. Nov. 10, 2014) (striking multiple affirmative defenses as "not proper affirmative defense" after concluding that each were "just different ways of saying that plaintiffs have failed to state a claim for relief"). The Court has already concluded that such a defense is not technically an affirmative defense. Moreover, while the Nano Defendants aver that the Italian bankruptcy proceedings may prohibit Fabian's claims, they fail to elaborate on how such proceedings would impact the claims here. Thus, this affirmative defense is appropriately stricken.

Eighth Affirmative Defense: Laches. **DENIED**. Although the allegations in the answer are bare, the Court finds that they sufficiently put Fabian on notice of the "laches" affirmative defense. Thus, the Court declines to strike this affirmative defense.

Ninth Affirmative Defense: Supervening Cause. **GRANTED**. The Court concludes that the "supervening cause" affirmative defense lacks sufficient allegations to place Fabian on notice. *See, e.g., J & J Sports Prods. v. Mendoza-Govan*, No. C 10-05123 WHA, 2011 WL 1544886,

at *4 (N.D. Cal. Apr. 25, 2011) ("Defendant does not indicate who, besides defendant, may have caused plaintiff's damages. In addition, she does not indicate what conduct by plaintiff or third parties allegedly caused the damages.") (citing *G &G*, 2010 WL 3749284, at *2 (finding the defense of "superseding acts of third persons" to be insufficiently pled because the defendants did not identify any superseding acts of third persons)). Thus, this affirmative defense is appropriately stricken.

Tenth Affirmative Defense: Indemnification / Innocence. **GRANTED**. First, as Fabian highlights, "Indemnification is not an affirmative defense, 'but rather a claim that must be pleaded and proved.' " *G & G Closed Circuit Events, LLC v. Nguyen*, No. 10-CV-05718, 2011 WL 6293922, at *3 (N.D. Cal. Dec. 15, 2011) (quoting *J & J Sports Prods. v. Vizcarra*, No. 11-1151 SC, 2011 WL 4501318, at *3 (N.D. Cal, Sep. 27, 2011) ("If Defendants believe they are entitled to indemnification by Direct TV, then they must bring an action against Direct TV. Accordingly, the Court strikes Defendants' second and fifth affirmative defenses with prejudice.")). Second, the Court cannot otherwise determine how an "innocence" affirmative defense is anything other than a general denial defense. The Nano Defendants fail to provide any authority demonstrating the appropriateness of this affirmative defense. Thus, this affirmative defense is appropriately stricken.

***7** Additional Affirmative Defense: Reservation to Add Affirmative Defenses. **DENIED**. Fabian seeks to strike a reservation to add affirmative defenses. Thus, the Court declines to strike this reservation, which is not, by definition, an affirmative defense.

Accordingly, the motion to strike affirmative defenses raised in the Nano Defendants' answer is **GRANTED IN PART** and **DENIED IN PART**.

IV. MOTION TO DISMISS FOR *FORUM NON CONVENIENS* [3]

A. Legal Standard

"Dismissal pursuant to the doctrine of *forum non conveniens* is a 'drastic exercise of the court's inherent power' and one that is 'an exceptional tool to be employed sparingly ...' 'The mere fact that a case involves conduct or plaintiffs from overseas is not enough for dismissal ...' A defendant must show that the chosen forum results in 'oppressiveness and vexation ... out of proportion to the Plaintiff's convenience.' " *Kedkad v. Microsoft Corp., Inc.*, No. C13-0141-THE, 2013 WL 5945807, at *2 (N.D. Cal. Nov 4, 2013); *see also Ridgway v. Phillips*, 383 F. Supp. 3d 938, 948-49 (N.D. Cal. 2019) (defendants must make a clear showing of facts establishing that litigating in this forum is so "oppressive and vexatious" as to be "out of proportion to plaintiff's convenience.").

"To prevail on a motion to dismiss based on *forum non conveniens*, a defendant bears the burden of demonstrating: (1) the adequacy of the alternative forum and (2) that the balance of private and public interest factors favors dismissal.... A forum non conveniens determination is committed to the sound discretion of the district court." *Kedkad*, 2013 WL 5945807, at *2 (internal citations and quotation marks omitted). *See also* *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 247-52 (1981). "In a motion to dismiss on the ground of *forum non conveniens*, the burden of proving an alternative forum is the defendant's and ... the remedy must be clear before the case will be dismissed." *Cheng v. Boeing Co.*, 708 F.2d 1406, 1411 (9th Cir. 1983), *cert. denied*, 464 U.S. 101 (1983). "In carrying this burden, [a defendant] must provide sufficient information to enable the district court to balance the parties' interests." *Contact Lumber Co. v. P.T. Moges Shipping Co.*, 918 F.2d 1446, 1449 (9th Cir. 1990). This standard requires a "clear showing of facts." *Carijano v. Occidental Petroleum Corp.*, 643 F.3d 1216, 1236 (9th Cir. 2011).

***8** "[U]nless the balance [of conveniences] is strongly in favor of the defendant, the plaintiff's choice of forum should rarely be disturbed." *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 508 (1947). "When the home forum has been chosen, it is reasonable to assume that this choice is convenient. When the plaintiff is foreign, however, this assumption is much less reasonable." *Piper Aircraft Co.*, 454 U.S. at 255-56. Further, "the greater the degree of deference to which the plaintiff's choice of forum is entitled, the stronger a showing of inconvenience the defendant must make to prevail in securing *forum non conveniens* dismissal." *Iragorri v. United Technologies Corp.*, 274 F.3d 65, 74 (2d Cir. 2001). "Although great weigh is generally accorded plaintiff's choice of forum, when an individual ... represents a class, the named plaintiff's choice of forum is given less weight." *Hendricks v. StarKist*, Case No. 13-cv-729-YGR, 2014 WL 1245880, at

*2 (N.D. Cal. Mar. 25, 2014) (citing *Lou v. Belzberg*,834 F.2d 730, 739 (9th Cir. 1987)). However, in class actions, courts have still given some deference to the named plaintiff's choice of forum where the plaintiff lived in the transferor district and the events at issue occurred in the transferor district. *Id.* at *2-3.

Here, Fabian chose his home forum where some of the events at issue occurred – a presumptively convenient choice which should ordinarily not be disturbed. *See* *Carijano*, 643 F.3d at 1227 ("When a domestic plaintiff initiates litigation in its home forum, it is presumptively convenient."). Thus, the Court gives some deference to Fabian's choice of forum.

B. Analysis

Here, the Nano Defendants aver that the complaint should be dismissed on the ground of *forum non conveniens*. Specifically, the Nano Defendants contend that the appropriate forum is Italy, and not the Northern District of California. Based on the foregoing authority, the Court first determines the the adequacy of the alternative forum, Italy, before reviewing the private and public interest factors, and, finally, balancing these factors to determine whether the complaint should be dismissed. As discussed below, the Court concludes that, on balance, a dismissal on the doctrine of *forum non conveniens* is not warranted here.

1. Whether Italy is An Adequate Alternative Forum

"An alternative forum is deemed adequate if: (1) the defendant is amenable to process there; and (2) the other jurisdiction offers a satisfactory remedy." *Carijano*, 643 F.3d at 1225. Furthermore, "[t]he foreign court's jurisdiction over the case and competency to decide the legal questions involved will also be considered." *Id.* (*citing Leetsch v. Freedman*, 260 F.3d 1100, 1103 (9th Cir. 2001)).

Fabian does not contest the first factor – that the defendants are amenable to process in Italy. Nor can he contest this factor, where the Nano Defendants have uniformly indicated that they would be amenable to process in Italy. Along with the BitGrail Defendants, who are based in Italy, the first factor is clearly satisfied.

With regards to the second factor, Fabian avers that Italy does not offer a satisfactory remedy such that it is an adequate alternative forum. Specifically, Fabian asserts that the Nano Defendants do not demonstrate that Fabian can achieve similar relief on behalf of a nationwide class in the Italian courts. Moreover, Fabian contends that the bankruptcy proceedings in Italy would likely stay any relief Fabian could obtain, that class actions are not as successful in Italian courts as they are in United States federal actions, and that the discovery process is more cumbersome and limited in Italian courts.

These arguments do not persuade. Courts routinely reject arguments that limited discovery and the difficulties of certifying a class, as compared to federal courts in the United States, are relevant to a determination of whether an alternative forum is adequate. *See, e.g.,* *Carijano v. Occidental Petroleum Corp.*, 548 F. Supp. 2d 823, 830 (C.D. Cal. 2008) ("The fact that Peru lacks a class action mechanism does not make it inadequate for forum non conveniens purposes."), *rev'd on other grounds*, 643 F.3d 1216 (9th Cir. 2011); *Deirmenjian v. Deutsche Bank, A.G.*, No. 06-CV 06-774, 2006 WL 4749756, at *8 (C.D. Cal. Sept. 25, 2006) ("The mere fact that Germany lacks a class action mechanism does not make it inadequate for forum non conveniens purposes, however."); *Sarei v. Rio Tinto PLC*, 221 F. Supp. 2d 1116, 1170 (C.D. Cal. 2002) ("Nonetheless, the court finds that the unavailability of class actions ... do not render Papua New Guinea an inadequate forum for forum non conveniens purposes."); *Harp v. Airblue Ltd.*, 879 F. Supp. 2d 1069, 1074 (C.D. Cal. 2012) ("Differences in discovery procedures do not provide a sufficient basis for finding an alternative forum to be inadequate."); *In re Air Crash Over the Taiwan Straits on May 25, 2002*, 331 F. Supp. 2d 1176, 1187 (C.D. Cal. 2004) ("Plaintiffs' arguments regarding the availability of ... pretrial discovery ... do not warrant a finding that Taiwan's procedural safeguards are inadequate for forum non conveniens purposes."); *Pavlov v. Bank of NY Inc.*, 135 F. Supp. 2d 426, 434-35 (S.D.N.Y. 2001) ("[T]he unavailability of pretrial discovery ... does not render the forum inadequate.").

***9** Instead, it is only "where the remedy offered by the other forum is clearly unsatisfactory" will an alternative forum be inadequate. *Piper*, 454 U.S. at 245 n.22. "A foreign forum must merely provide *some* remedy." *Ranza v. Nike, Inc.*, 793 F.3d 1059, 1077 (9th Cir. 2015) (emphasis supplied). In other words, for an alternative forum to fail to

be adequate, the remedy provided there must be "so clearly inadequate or unsatisfactory, that it is no remedy at all." *Lueck v. Sundstrang Corp.*, 236 F.3d 1137, 1143 (9th Cir. 2001) (internal quotation marks omitted).

Here, based on the record including the declarations submitted by the Nano Defendants, the Court concludes that Italy is an adequate alternative forum to hear the claims at issue. The courts are open, impartial, and authorized to provide full compensatory damages for the wrongs alleged in the amended complaint. While any Italian based proceedings would be stayed pending the ongoing BitGrail bankruptcy proceedings in Italy, such a stay does not ultimately preclude the relief sought in Italy. Indeed, courts that have specifically considered the adequacy of Italian courts have generally found Italian courts as an adequate alternative forum. *See Costa Sandoval v. Carnival Corp.*, No. 12-CV-5517, 2014 WL 12585803, at *4 (C.D. Cal. Sept. 15, 2014) (holding Italy adequate to hear negligence claims related to shipwreck); *Giglio Sub S.N.C. v. Carnival Corp.*, No. 12-CV-21680, 2012 WL 4477504, at *13 (S.D. Fla. Sept. 26, 2012) (same). Thus, the Court here similarly concludes that Italy is an adequate alternative forum.

2. Private Interest Factors

The private interest factors to consider when determining whether to grant a motion to dismiss for *forum non conveniens*, as enumerated by the Ninth Circuit in *Carijano*, are as follows: (1) the residence of the parties and the witnesses; (2) the forum's convenience to the litigants; (3) access to physical evidence and other sources of proof; (4) whether unwilling witnesses can be compelled to testify; (5) the cost of bringing witnesses to trial; (6) the enforceability of the judgment; and (7) all other practical problems that make trial of a case easy, expeditious and inexpensive. *See Carijano*, 643 F.3d at 1229 (citing *Boston Telecomms. Grp. v. Wood*, 588 F.3d 1201, 1206-07 (9th Cir. 2009)). The Court considers each of these factors in turn below. Thus:

1. Residence of the Parties and the Witnesses. When reviewing this factor, courts look to "the materiality and importance of the anticipated witnesses' testimony." *Kleiner v. Spinal Kinetics, Inc.*, No. 5:15-cv-02179-EJD, 2016 WL 1565544, at *4 (N.D. Cal. Apr. 19, 2016) (*quoting Gates Learjet Corp. v. Jensen*, 743 F.2d 1325, 1335-36 (9th Cir. 1984)). "The key inquiry ... requires assessing the materiality and importance of these witnesses' testimony and determining whether some of these witnesses are 'critical' and beyond the jurisdiction of domestic courts." *Kleiner*, 2016 WL 1565544, at *4; *see also Lueck*, 236 F.3d at 1146 ("We have said previously that a court's focus should not rest on the number of witnesses or quantity of evidence in each locale. Rather, a court should evaluate 'the materiality and importance of the anticipated [evidence and] witnesses' testimony and then determine ... their accessibility and convenience to the forum.' ") (quoting *Gates Learjet Corp. v. Jensen*, 743 F.2d 1325, 1335-36 (9th Cir. 1984)).

Here, Fabian is a resident of Discovery Bay, California, which is within the boundaries of the United States District Court of the Northern District of California. Based on the amended complaint, some of the actions occurred within the district. Moreover, to the extent that California law applies, California itself has an interest in preventing fraud within its borders. *See Boston Telecomms. Grp. v. Wood*, 588 F.3d 1201, 1212 (9th Cir. 2009) (California has an "interest in preventing fraud from taking place within its borders.").

***10** Of the Nano Defendants: Nano is a Texas corporation with its principle place of business in Austin, Texas; LeMahieu is a resident of Texas, but has spent significant time in Europe; Shapiro lives in New York; Retzer lives in Massachusetts; and Busch lives in Illinois. Thus, some material information is likely in the hands of the Nano Defendants who are located primarily throughout the United States.

In addition to the Italy-based BitGrail Defendants, the Nano Defendants also identify several witnesses in Italy that, they assert, are crucial to the matter here. These witnesses include: (1) the bankruptcy court-appointed expert, the *Consulete Tecnico d'Ufficio*, Dal Checco; (2) the experts retained by Firano, the public prosecutor's office, and the principal creditor, Eirik Ulversøy, in the same proceedings; (3) Firano's partner, Andrea Davoli; (4) assistants who helped Firano and Davoli operate BitGrail; and (5) the prosecutors investigating Firano's criminal liability in the matter.

These individuals identified above present a close question: some of these individuals appear to have material and important information related to this litigation, and others do not. Indeed, the Court cannot determine how expert witnesses appointed by the Italian bankruptcy court, the expert witnesses retained by the parties in the Italian

proceedings, and the public prosecutors themselves could be material witnesses in this matter. [4] But the Court recognizes that BitGrail, Firano, Davoli, and the assistants who helped run BitGrail may indeed be material and important witnesses in this matter. As a whole, the Court notes that some material and important witnesses are located throughout the United States – relating to the Nano Defendants – and Italy – relating to the BitGrail Defendants. Thus, on balance, this factor weighs neutrally between the two forums.

2. Forum's Convenience to the Litigants. The Nano Defendants only identify LeMahieu's inconvenience in traveling to this district in support of Italy as an alternate forum. Specifically, at the time of the briefing of this motion, Le Mahieu was residing in Madrid, Spain. [5] However, where the remainder of the parties in this action, aside from the BitGrail defendants and LeMahieu, reside in the United States, the Court is not persuaded that this factor weighs in favor of Italy over California. Indeed, the undisputable facts – that Fabian and lead counsel are located here in this district and that most of the defendants reside in the United States – show that this district is highly convenient to the parties. *See* *In re Volkswagen "Clean Diesel" Mktg., Sales Practices, & Prods. Liab. Litig.*, No. 2672 CRB (JSC), 2017 WL 66281, at *9 (N.D. Cal. Jan. 4, 2017) ("The forum is clearly convenient for Plaintiffs as they brought suit here."); *Carijano*, 643 F.3d at 1227 ("When a domestic plaintiff initiates litigation in its home forum, it is presumptively convenient.").

***11** Thus, this factor weighs in favor of the United States and California over Italy.

3. Access to Physical Evidence and Other Sources of Proof. When evidence is available under the Hague Convention, this factor tends to weigh in favor of the potential transferor jurisdiction. *See* *Tuazon v. R.J. Reynolds Tobacco Co.*, 433 F.3d 1163, 1181 (9th Cir. 2006) ("Any court ... will necessarily face some difficulty in securing evidence from abroad," but that does not justify dismissal when the administrative costs are not particularly great); *Boston Telecom.*, 588 F.3d at 1210 (determining that this factor is neutral when seeking evidence from a foreign jurisdiction under the Hague Convention, and "do[es] not necessarily justify dismissal.").

Here, the parties point to evidence in both locations – in Italy and the United States. Fabian highlights that some evidence is likely in the hands of the Nano Defendants themselves. On the other hand, the Nano Defendants identify that relevant and significant evidence exists in Italy. Moreover, the Nano Defendants' expert witness notes that obtaining documents through the Hague Convention would be "time consuming, expensive, and complicated."

These arguments do not persuade. Expensiveness and complexity aside, the Nano Defendants concede that the Hague Convention would permit the parties to obtain the evidence in Italy. The Court recognizes that a significant portion of evidence – evidence that would likely be relevant to the Nano Defendants' affirmative defenses – is within Italy. However, where the Hague Convention would permit both parties access to the evidence, the Court cannot conclude that this factor weighs in favor of Italy. Thus, this factor is neutral as to the two forums.

4. Whether Unwilling Witnesses Can Be Compelled to Testify. Where no unwillingness of witnesses to appear has been shown, this factor does not tend to weigh in favor dismissal. *See* *Carijano*, 643 F.3d at 1231 (*citing* *Duha v. Agrium, Inc.*, 448 F.3d 867, 877 (6th Cir. 2006)).

Here, the Nano Defendants aver that the BitGrail Defendants, and witnesses associated with the BitGrail Defendants are unlikely to appear in this action. The Nano Defendants further highlight that the Nano Defendants are willing to submit themselves to the jurisdiction of Italy, and that this factor therefore weighs in favor of Italy. Fabian responds that this determination is premature where the Court, at the time of the briefing the motion to dismiss, had not yet ruled on the motion for alternate service on the BitGrail defendants.

Fabian's arguments do not persuade. While the Court cannot make a final determination as to whether the BitGrail Defendants will appear as this Order only just effectuated service on the BitGrail Defendants, the Court notes that, in light of the Nano Defendants' statement of their submission to the Italian Courts, Italy appears to be the only forum where all witnesses would willingly appear. Thus, at this time, this factor weighs slightly in favor of Italy.

5. Cost of Bringing Witnesses to Trial. "The factor relating to the cost of bringing witnesses to trial is largely tied to the location of witnesses with material information regarding the Plaintiff's claims." *See* *Kleiner*, 2016 WL 1565544, at *4.

***12** Here, as discussed, the parties and material witnesses are located throughout the United States and Europe. Neither travel to California nor Italy is particularly cheap for the entirety of the parties and witnesses in this matter. Thus, this factor is neutral as to the two forums.

6. Enforceability of the Judgment. The Nano Defendants aver that proceedings in Italy would be automatically enforceable globally in light of their waivers to accept judgment from the Italian courts. The Nano Defendants highlight that there may be some issues for Fabian and the class in obtaining a judgment against the BitGrail defendants, in light of the ongoing bankruptcy proceedings, and that enforcing a judgment from a United States district court is not automatically enforceable in Italy. Thus, this factor weighs slightly in favor of Italy.

7. All Other Practical Problems. The Court concludes that neither party provides persuasive arguments on this factor, nor identifies any further practical problems that are relevant to the determination here. Thus, this factor is neutral as to the two forums.

3. Public Interest Factors

The public interest factors, as enumerated by the Ninth Circuit in *Carijano*, are as follows: (1) the local interest in the lawsuit, (2) the court's familiarity with the governing law, (3) the burden on local courts and juries, (4) congestion in the court, and (5) the costs of resolving a dispute unrelated to a particular forum. *See* *Carijano*, 643 F.3d at 1232 (*citing Boston Telecomms.*, at 1211). The Court considers each of these factors in turn below. Thus:

1. Local Interest in the Lawsuit. In deciding this factor, the Court "need not hold, California is the principal locus of the case or that California has more of an interest than any other jurisdiction to conclude that California has a meaningful interest in this litigation. [W]ith this [public] interest factor, we ask only if there is an identifiable local interest in the controversy, not whether another forum also has an interest ... California has an interest in preventing fraud from taking place within its borders." *Boston Telecom*, 588 F.3d at 1212; *see also Kleiner*, 2016 WL 1565544, at *6 ("Here, the court finds that Germany has a significant local interest in this lawsuit. Plaintiffs are residents of Germany, underwent their respective implantation operations in Germany, and suffered similar injuries there.").

The Nano Defendants' arguments to the contrary notwithstanding, California has a meaningful interest in the controversy as "California has an interest in preventing fraud from taking place within its borders." Although the Nano Defendants characterize Fabian's actions in this state as constituting of a "few mouse clicks," such actions are still significant enough that Fabian is now seeking to recover damages that he and the similarly situated proposed class sustained that resulted from those clicks.

Thus, the Court concludes that this factor weighs against dismissal and in favor of California.

2. Court's Familiarity with the Governing Law. Unless certain federal statutes are implicated, district courts do not need to make a definitive choice of law determination for the purposes of deciding a *forum non conveniens* motion. *See* *Lueck*, 236 F.3d at 1148. Here, based on the parties' briefing, the Court expressly declines to make a definitive choice of law determination. However, the Court is not persuaded that Italian law conclusively governs the claims against the defendants or that Italy has a significant interest in seeing its laws applied that is greater than California's (or another United States jurisdiction's) interest. This is especially so where the class to be certified is a United States national class led by a California based lead plaintiff. Moreover, the defendants in this lawsuit include several United States citizens as well as a company organized within the United States. Thus, the Court concludes that this factor weighs in favor of California.

***13** 3. Burden on Local Courts and Juries. The Nano Defendants aver that this Court would require numerous exhibits and pieces of evidence translated from Italian into English. The Nano Defendants' arguments do not persuade. The inverse is also true: there are several pieces of evidence in English in the possession of the Nano Defendants and there are claims that would likely require the application of California law to reach resolution. The Italian courts would therefore be left in a similar situation of requiring translations of material evidence. This is unsurprising given the global nature of the commerce in this action. The Court is otherwise unpersuaded by the parties' remaining arguments. Thus, the Court concludes that this factor weighs neutrally.

4. Congestion in the Court. "The determinative inquiry regarding th[is] factor[ ] is whether a trial would be speedier in another court due to a less crowded docket." *Kleiner*, 2016 WL 1565544, at *7. As the Nano Defendants highlight and the Court acknowledges, the Northern District of California has a significant number of civil filings and pending motions per judge. The Nano Defendants also submit evidence that Italian proceedings have "tight timelines" for pleadings and briefings. However, in light of the bankruptcy stay in Italy, it is unclear whether proceedings in Italy would be faster than proceedings in this district. Thus, the Court concludes that this factor weighs neutrally.

5. Costs of Resolving a Dispute Unrelated to a Particular Forum. The Nano Defendants aver that California has minimal interest in this dispute. On the other hand, Fabian asserts that California has a significant interest in this litigation. In light of the Court's prior findings – that California has an interest in this litigation, and that the costs weigh evenly between the forums – the Court finds that this factor weighs slightly in favor of California.

4. The Weighing of the Private and Public Factors

In light of the foregoing analysis, the Court concludes that the balance of factors is close, but that the balance does not warrant a dismissal of this case on the grounds of *forum non conveniens*. Indeed, the Court remarks that this case only demonstrates the global interconnectedness of the cryptocurrency market: where cryptocurrency programmers, operators, and consumers on both sides of the transactions can be from numerous and different countries. Despite this close balancing, the Court notes that even if some factors were shifted in favor of Italy, it would not be enough to disturb Fabian's choice of forum in his home forum, which here is entitled to some deference. In other words, the Nano Defendants have failed to demonstrate the continued litigation in this district results in "oppressiveness and vexation" that is "out of proportion" to the Fabian's convenience to his choice of forum.

Accordingly, in light of the above, the Court **DENIES** the motion to dismiss for *forum non conveniens.*

V. CONCLUSION

For the foregoing reasons, the Court **HEREBY ORDERS** as follows:

(1) the motion for leave to effect alternative service is **GRANTED**;

(2) the motion to strike affirmative defenses raised in the Nano Defendants' answer is **GRANTED IN PART** and **DENIED IN PART**; and

(3) the motion to dismiss for *forum non conveniens* is **DENIED**.

Further, the Nano Defendants request leave to amend to remedy any dismissed affirmative defense. In light of the foregoing, the Court **GRANTS** the request for leave to amend the answer solely to the ninth affirmative defense. Such an amended answer shall be due within fourteen (14) days of the date of this Order. Fabian is prohibited from filing a motion with respect to that affirmative defense without permission from the Court.

***14** This Order terminates Docket Numbers 81, 84, and 85.

IT IS SO ORDERED.

All Citations

Slip Copy, 2020 WL 3402800

Footnotes

1 *See also Fabian v. LeMahieu*, 4:19-cv-00054-YGR, 2019 WL 4918431, at *2-7 (N.D. Cal. Oct. 4, 2019).

2 The Court highlights that the Nano Defendants concede that, should California law apply to this class action, such a defense is not recognized under California law.

3 The parties have filed several ancillary requests and objections with regards to evidence in support of the motion to dismiss for *forum non conveniens.* First, Fabian's request for judicial notice of the deposition transcript of LeMahieu. (Dkt. No. 101.) That request is **DENIED**, as deposition transcripts are not properly subject to judicial notice by Courts. *See* *Warwick v. Bank of New York Mellon*, No. CV 15-3343, 2016 WL 2997166, at *11 (C.D. Cal. May 23, 2016); *Hernandez v. Santa Clara Cty. Sheriff's Dep't*, No. 06-CV-6977, 2009 WL 1537877, at *1 n.1 (N.D. Cal. June 2, 2009). The Court does consider the evidence in so far as it constitutes admissions by LeMahieu under Federal Rule of Evidence 801. Second, Fabian objects to the evidence submitted by the Nano Defendants in connection with the reply. (Dkt. Nos. 95 (objections), 98 (opposition).) Having reviewed the briefing and the arguments therein, these objections are **OVERRULED**.

4 Moreover, the Nano Defendants provide no authority that such individuals are even appropriately called as witnesses in the Italian courts. While the Court is unfamiliar with the nuances of Italian law, the Court expresses skepticism at the notion that public prosecutors in parallel criminal proceedings can be called as fact or expert witnesses in related civil proceedings.

5 The Court recognizes that – in light of the ongoing coronavirus pandemic (COVID-19), LeMahieu may no longer reside in Madrid.

End of Document

TAB 35

Hunichen v. Atonomi LLC, Case No. 19-0615 (W.D. Wash.) 2021 WL 5858811

2021 WL 5858811
Only the Westlaw citation is currently available.
United States District Court, W.D. Washington, at Seattle.

Chris HUNICHEN, individually and on behalf of all others similarly situated, Plaintiff,

v.

ATONOMI LLC, et al., Defendants.

Atonomi LLC, Counterclaimant/Third-Party Plaintiff,

v.

Chris Hunichen, Counter-Defendant,

and

David Patrick Peters, et al., Third-Party Defendants.

CASE NO. C19-0615-RAJ-SKV
|
Signed 11/12/2021

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REPORT AND RECOMMENDATION

S. KATE VAUGHAN, United States Magistrate Judge

INTRODUCTION

***1** Plaintiff Chris Hunichen, individually and on behalf of all others similarly situated, pursues a single cause of action alleging violation of the Washington State Securities Act (WSSA), RCW 21.20.010 et seq., through the sale of unregistered, non-exempt securities. Dkt. 137. Defendant Atonomi LLC (Atonomi) filed Counterclaims against Plaintiff and a Third Party Complaint. Dkts. 81-82. The Court's Report and Recommendation that those counterclaims and third party claims be dismissed with prejudice remains outstanding. *See* Dkt. 218.

Plaintiff now proceeds on a Motion for Class Certification. Dkt. 197. He seeks certification pursuant to Federal Rule of Civil Procedure 23(a) and 23(b)(3), his appointment as Class Representative, and the appointment of his legal representatives as Class Counsel pursuant to Rule 23(g).

Defendants Atonomi, CENTRI Technology, Inc. (CENTRI), M37 Ventures Inc. (M37), Vaughan Emery, Rob Strickland, Don DeLoach, Wayne Wisehart, Michael Mackey, and James Salter oppose the motion. Dkt. 208. Claims against the remaining Defendants – Launch Capitol LLC (Launch), Steven J. "Woody" Benson, and David Fragale – are the subject of a contemporaneous Report and Recommendation to grant Plaintiff's Motion for Preliminary Approval of a Partial Class-Wide Settlement. [1]

The parties to the current dispute request oral argument. The Court, having considered the motion, opposition, and remainder of the record, finds oral argument unnecessary and recommends the Motion for Class Certification, Dkt. 197, be GRANTED.

BACKGROUND

A. ATMI Tokens

This matter involves the sale of "ATMI tokens." As previously described by the Court, Defendants maintain the tokens were created for use as a utility on the "Atonomi Network" and sold to fund the network and raise money for the development of blockchain technology. *See* Dkt. 208 at 4 and Dkts. 40 & 86 (providing background information regarding ATMI tokens and associated technology). Plaintiff rejects Defendants' depiction of the tokens as a utility. He posits that CENTRI and other Defendants created Atonomi as a CENTRI subsidiary in order to raise funds to retire a debt owed to Launch and developed the idea of a token sale before conceiving any use or application for a token. Dkt. 197 at 6-7.

B. Token Sales

In the first half of 2018, Atonomi held a private pre-sale of ATMI tokens which required a purchaser to enter into a Simple Agreement for Future Tokens (SAFT). *See* Dkts. 40, 86 & 137. The SAFT identifies the purchaser as an accredited investor as defined in Rule 501 of Regulation D of the Securities Act. Dkt. 199, Ex. 29 at § 6(b). Defendants sought exemption from registration of the SAFT as a security under Rule 506(b) of Regulation D. Dkt. 86 at 7-8, 12 (citing Dkt. 46, Ex. A (Form D filed with SEC in March 2018)). Eighty people, including Plaintiff, all putative class members, and four current/former Defendants (Emery, Wisehart, De Loach, and Luis Pares), entered into SAFTs. *See* Dkt. 199, Ex. 28. SAFT signatories agreed to purchase tokens in exchange for Ethereum (ETH) cryptocurrency pursuant to a formula laid out in the SAFT and were entitled to additional "bonus" tokens. *Id.*, Ex. 29.

***2** Atonomi subsequently conducted a public sale of tokens that both began and concluded on June 6, 2018 and allowed purchase of tokens without signing a SAFT. *See* Dkts. 40, 86 & 137. Some fourteen thousand people participated in the public sale, which offered a price of 0.00010526316 ETH per ATMI token. *See* Dkt. 199, Ex. 16 at 3 and Ex. 31 at 14. Each public sale participant was required to register and agreed to be bound to Atonomi's "Terms of Token Sale", which included a binding arbitration clause. *Id.*, Ex. 31 at 1-2.

Atonomi made 135,000,000 ATMI tokens available for sale to the public and planned to deliver 365,000,000 tokens to SAFT purchasers. *Id.* at 14. It released and delivered tokens to both the private and public sale participants on July 12, 2018 and delivered bonus tokens on September 7, 2018. Dkt. 198, ¶7. The ATMI token "crashed" shortly after delivery. *See* Dkt. 197 at 12; Dkt. 208 at 15.

C. Allegations Relevant to Certification

Plaintiff deems the ATMI token a " 'dead' coin", with no demand, trading, or worth. Dkt. 137, ¶163; Dkt. 197 at 12. He contends the two-stage "Initial Coin Offering" or "ICO" described above comprised a single "integrated" offering. *See* Dkts. 137 & 197-98. He alleges he and other putative class members purchased ATMI tokens as an investment, that the tokens are now worthless, and that Defendants, who raised some $25 million in the token sales, are liable for the sale of unregistered, non-exempt securities in violation of the WSSA. Dkt. 137.

Defendants maintain the alleged "ICO" inaccurately describes its "Public Token Sale." Dkt. 208 at 6 & n.4. They deny violation of the WSSA, contending the SAFT was exempt from registration and that the tokens are not securities. *See* Dkts. 40, 86 & 208. Defendants also contend Plaintiff/Counter-Defendant and the Third Party Defendants violated the terms of the SAFT by "dumping" tokens shortly after they were unlocked, causing a chain reaction and the value of the tokens to crash. *See* Dkt. 208. The Court has recommended these counterclaims and the Third Party Complaint be dismissed. Dkt. 218.

D. Proposed Class, Class Representative, and Class Counsel

Plaintiff seeks to certify a class defined as follows:

> All persons who purchased ATMI tokens via a Series 1 or Series 2 SAFT with Atonomi, LLC in 2018.
>
> Excluded from the Class are Defendants and persons or entities directly affiliated with any Defendant, and persons who affirmatively assented to the Atonomi "Terms of Token Sale."

Dkt. 197 at 5. The SAFTs signed by Plaintiff and all proposed class members are identical in all material respects except as to the "specific information pertaining to [the investor] including [their] investment amount." Dkt. 81, ¶¶15-20; Dkt. 82, ¶¶14-19.

Plaintiff and proposed class representative Chris Hunichen signed a SAFT reflecting his payment of 225 ETH, a cryptocurrency amount then valued at $191,250.00. Dkt. 198, ¶6; Dkt. 199, Ex. 29 at 2. He received 2,137,500 ATMI tokens on their release, followed by 534,375 bonus tokens. Dkt. 198, ¶7. In subsequent transfers and sales, Plaintiff received the equivalent of over $29,000 in ETH and asserts a total minimum dollar loss of $161,514.99. *Id.*, ¶¶8-15. Plaintiff signed the SAFT while residing in Costa Rica, but currently resides in and is a permanent resident of Nevada. *Id.*, ¶2; Dkt. 199, ¶30 & Ex. 29. Other putative class members likewise signed SAFTS in other countries and in some cases reside in other countries and/or were not United States residents at the time of signing. *See* Dkt. 199, Ex. 28.

***3** Counsel for Plaintiff attest to their expertise in securities litigation, class actions, and other complex litigation. Dkt. 199, Exs. 50-52.

DISCUSSION

A. Legal Standard

The class action is " 'an exception to the usual rule that litigation is conducted by and on behalf of the individually named parties only.' " *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 348 (2011) (quoting *Califano v. Yamasaki*, 442 U.S. 682, 700-01 (1979)). Under Rule 23(a), a court may certify a class only if: (1) the class is so numerous joinder of all members is impracticable; (2) questions of law or fact are common to the class; (3) a representative party's claims or defenses are typical of the claims or defenses of the class; and (4) the representative party will fairly and adequately protect the interests of the class. Fed. R. Civ. P. 23(a). The court must also find satisfaction of at least one of three alternative conditions set forth in Rule 23(b), including, as relevant to this case: (1) that questions of law or fact common to members of the class predominate over any questions affecting only individual members, and (2) that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. Fed. R. Civ. P. 23(b)(3).

The party seeking certification bears the burden of demonstrating satisfaction of Rule 23(a) and Rule 23(b). *Lozano v. AT&T Wireless Servs., Inc.*, 504 F.3d 718, 724 (9th Cir. 2007). The Court's decision to certify a class is discretionary, but guided by Rule 23. *Vinole v. Countrywide Home Loans, Inc.*, 571 F.3d 935, 944 (9th Cir. 2009). The Court must undertake a "rigorous analysis" to determine whether the party seeking certification satisfies the Rule 23 prerequisites. *Dukes*, 564 U.S. at 351.

The Court accepts the allegations in the complaint as true so long as they are sufficiently specific to permit an informed assessment as to whether the requirements of Rule 23 have been satisfied. *Blackie v. Barrack*, 524 F.2d 891, 901 & n.17 (9th Cir. 1975). The merits of the substantive claims are not, as a general matter, relevant to this inquiry. *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177-78 (1974). "Merits questions may be considered to the extent—but only to the extent—that they are relevant to determining whether the Rule 23 prerequisites for class certification are satisfied." *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, 568 U.S. 455, 466 (2013) (citations omitted).

B. Rule 23 Analysis

Plaintiff argues the proposed class satisfies the above-described numerosity, commonality, typicality, and adequacy requirements of Rule 23(a), as well as the predominance and superiority requirements of Rule 23(b)(3). Defendants disagree on all counts. The Court finds both Rule 23(a) and Rule 23(b)(3) satisfied and certification of a class warranted.

1. Numerosity and Superiority:

Plaintiff identifies seventy-six SAFT signatories as members of the proposed class, a number including all but the four Defendants who entered into SAFTs. Defendants raise a challenge to the proposed class implicating both the numerosity and superiority requirements, as discussed below.

a. Numerosity standard:

***4** Numerosity exists when "the class is so numerous that joinder of all members is impractical." Fed. R. Civ. P. 23(a)(1). "It is a long-standing rule that 'impractical' does not mean 'impossible' rather, impracticability means only 'the difficulty or inconvenience of joining all members of the class.' " *McCluskey v. Trustees of Red Dot Corp. Emp. Stock Ownership Plan & Tr.*, 268 F.R.D. 670, 674 (W.D. Wash. 2010) (quoting *Harris v. Palm Springs Alpine Estates, Inc.*, 329 F.2d 909, 913-14 (9th Cir. 1964)). Factors pertinent to this determination include judicial economy, geographical diversity of class members, the ability of individual claimants to institute separate suits, and the pursuit of injunctive or declaratory relief. *See, e.g.*, *Dunakin v. Quigley*, 99 F. Supp. 3d 1297, 1326-27 (W.D. Wash. 2015); *McCluskey*, 268 F.R.D. at 674-76. Courts generally find forty or more class members to satisfy the numerosity requirement. *Id.* However, this prerequisite to certification "requires examination of the specific facts of each case and imposes no absolute limitations." *Gen. Tel. Co. of the Nw. v. Equal Emp. Opportunity Comm'n*, 446 U.S. 318, 330 (1980). *See also McCluskey*, 268 F.R.D. at 673-76 (certifying a class of 27, citing cases certifying classes ranging from 7 to 35 class members, and quoting another district court as observing, "[g]enerally, courts will find that the numerosity requirement has been satisfied when the class compromises 40 or more members and will find that it has not been satisfied when the class comprises 21 or fewer.") (citations omitted).

b. Superiority standard:

Superiority exists where a "class action is superior to other available methods for fairly and efficiently adjudicating the controversy." Fed. R. Civ. P. 23(b)(3). In making this determination, the Court must consider the four factors of Rule 23(b)(3): (A) class members' interests in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any already existing litigation concerning the controversy by or against class members; (C) the desirability or undesirability of concentrating the litigation in a particular forum; and (D) likely difficulties in managing a class action. *Zinser v. Accufix Rsch. Inst., Inc.*, 253 F.3d 1180, 1190 (9th Cir.), *as amended on denial of reh'g*, 273 F.3d 1266 (9th Cir. 2001) (citing Fed. R. Civ. P. 23(b)(3)(A)-(D)). The Court's superiority inquiry includes consideration of "whether the objectives of the particular class action procedure will be achieved in the particular case[,]" and "necessarily involves a comparative evaluation of alternative mechanisms of dispute resolution." *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1023 (9th Cir. 1998) (cited source omitted), *overruled on other grounds by* *Dukes*, 564 U.S. 338.

c. Numerosity and superiority in relation to the proposed class:

Plaintiff posits that the seventy-six member class clearly satisfies the numerosity requirement in that it well exceeds the recognized threshold and because joinder of that number of plaintiffs would be impracticable. Plaintiff also asserts superiority. He argues that, although many members of the class have significant damages, the additional trouble and expense of individual adjudication is overwhelming considering the identical factual and legal claims, the fact no other individual has filed an action and any such litigation would almost certainly occur in this forum, and the absence of any serious manageability issues given the class size, known class members, and the simple damage calculations.

Defendants deny superiority due to an absence of evidence a judgment or court-approved settlement in this matter would be given preclusive effect in the countries of forty-five putative class members who were not United States residents at the time they entered into SAFTs. *See* Dkt. 199, Ex. 28 (identifying signatories from twenty-five different countries). That is, Defendants contend the possibility that foreign putative class members could seek to file suit against Defendants in jurisdictions that would not recognize the *res judicata* effect of a judgment in this case undermines the superiority of the proposed class action. *See, e.g.*, *Willcox v. Lloyds TSB Bank, PLC*, C13-0508, 2016 WL 8679353, at *9 (D. Haw. Jan. 8, 2016) ("The *res judicata* concerns for [a] transnational class action ... are twofold: first, a foreign

plaintiff may get a second bite at the apple through subsequent litigation in her home forum, and second, a foreign court may not honor a domestic class judgment in a defendant's favor.") (citations omitted). Defendants argue the exclusion of foreign SAFT signatories destroys numerosity by leaving only a thirty-one member class.

***5** Courts have considered *res judicata* concerns when evaluating the superiority requirement and have excluded foreign putative class members on this basis. *See, e.g.*, *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 263-64 (2d Cir. 2016) (plaintiffs failed to identify any evidence suggesting foreign courts in certain countries would grant preclusive effect to a class judgment); *In re Alstom SA Sec. Litig.*, 253 F.R.D. 266, 282-84 (S.D.N.Y. 2008) (excluding French investors from proposed class where plaintiffs failed to demonstrate "French courts would more likely than not recognize and give preclusive effect to any judgment rendered" and defendant's organizational documents vested exclusive jurisdiction over disputes in a French court). Although not yet addressed by the Ninth Circuit, a district court within this circuit explained:

> The trending approach of federal courts nationwide appears to be evaluating the *res judicata* effects of class judgments with respect to groups of foreign plaintiffs and then excluding from the class those whose home countries would not honor a class judgment from the United States. Such exclusions have occurred notwithstanding these courts' recognition that class manageability is only one of multiple factors to be considered under Rule 23(b)(3), and that *res judicata* risks as to foreign plaintiffs should be evaluated "along a continuum." These courts have also clarified that it is plaintiffs' burden to "demonstrat[e] that 'foreign court recognition is more likely than not' " as to a U.S. class judgment.

Willcox, 2016 WL 8679353, at *9 (internal and other case citations omitted).

Defendants criticize the country-by-country case law analysis provided by Plaintiff, *see* Dkt. 197 at 21-23 & Appx. A, asserting he merely cites to non-precedential authority and no more than conjectures that a judgment would be enforced in Hungary, Russia, Czech Republic, Romania, Dubai, Germany, Croatia, India, Hong Kong, Switzerland, the United Kingdom, and Singapore; does not address Costa Rica or Australia; and fails to acknowledge contrary conclusions in regard to Hungary, Switzerland, Pakistan, and Russia. *See* Dkt. 208 at 12-13. Defendants assert the need for expert testimony, as well as counsels' lack of relevant expertise.

Defendants contend the small remaining class of United States residents does not satisfy the numerosity requirement. They note that no other SAFT signatory has threatened a lawsuit and argue the signatories' status as accredited investors shows they are financially and otherwise capable of bringing individual lawsuits.

The Court is not persuaded that inclusion of foreign putative class members defeats the superiority or numerosity requirements. The Court, instead, agrees with Plaintiff that Defendants rely on distinguishable case law and that the analysis is properly focused in a different direction.

Plaintiff's lawsuit is brought under a Washington law, against Washington defendants, and challenges a Washington ICO. Courts have, in similar circumstances, certified classes including foreign putative class members. For example, in *Marsden v. Select Med. Corp.*, 246 F.R.D. 480, 489 n. 7 (E.D. Pa. 2007), the court found inclusion of some foreign investors did not affect superiority because the "alleged wrongdoing by American defendants" took place in and involved stock traded in the United States, and it was "unclear that any foreign class members would even have recourse in their home countries[.]" The court distinguished cases involving foreign defendants and activity, such as the French defendant and activity in *In re Vivendi* and found it "far from clear" how the Austrian courts allegedly at issue in its case "would even have jurisdiction over a suit" alleging fraud under United States securities laws. *Id.* at 486.

***6** More recently, in *Audet v. Fraser*, 332 F.R.D. 53, 84-85 (D. Conn. 2019), the court found *res judicata* case law distinguishable and the decision in *Marsden* to provide a better path for consideration of a cryptocurrency case and class involving foreign putative class members. The lawsuit involved a U.S. company, controlled by individuals living in the U.S. and their conduct in this country. The court found the superiority requirement satisfied, explaining:

> By itself, the existence of some foreign putative class members does not weigh against superiority as Fraser has not pointed to evidence or legal authority suggesting that any foreign courts

> would have jurisdiction over him or any other defendants. Fraser has pointed to no authority declining to certify a class on this basis in a case involving class members from inside and outside the United States and defendants whose conduct took place exclusively within the United States. While Plaintiffs bear the burden of establishing each element of Rule 23, they need not rebut objections to class certification that rest on speculative scenarios.

Id. at 85 (internal citation omitted). *See also Tsereteli v. Residential Asset Securitization Tr. 2006-A8*, 283 F.R.D. 199, 217-18 (S.D.N.Y. 2012) ("The foreign identity of prospective class members is a factor which can 'counsel[ ] against a finding that the class action is superior to other forms of litigation,' but it is 'not dispositive.' Where, as here, unique issues of foreign law involving foreign investors are minor or non-existent, superiority is not defeated.") (quoting *Ansari v. N.Y. Univ.*, 179 F.R.D. 112, 116–17 (S.D.N.Y. 1998)).

Also, in *Moomjy v. HQ Sustainable Mar. Indus., Inc.*, C11-0726-RSL, 2011 WL 4048796, at *2-3 (W.D. Wash. Sept. 12, 2011) (cleaned up), this Court noted that "courts routinely appoint foreign investors as lead plaintiffs" and found the argument an Estonian court might not recognize the judgment, raising *res judicata* concerns, "speculative and insufficient" to support a challenge to the adequacy of an Estonian investor as a lead plaintiff. The Court added that, while it would not appoint a lead plaintiff likely to be later excluded, the possibility was speculative and appeared unlikely where the Estonian lead plaintiff purchased its shares domestically, had agreed to be bound by any judgment from the court, Estonia recognizes foreign judgments, and objecting parties did not argue the lead plaintiff "could, as a practical matter, pursue its claim in Estonia." *Id.* (citing *Marsden*, 246 F.R.D. at 486).

Defendants here offer no more than bare and speculative *res judicata* concerns in relation to foreign putative class members. They do not identify acts or events that could give rise to jurisdiction in a foreign court or dispute that the conduct at issue occurred within the United States. A foreign court's jurisdiction over Defendants appears unlikely. [2]

***7** Plaintiff satisfies the superiority requirement. He proposes a single action in this forum, where the corporate and many of the individual defendants are based, state law governs the controversy, and the class includes a number of far-flung individual members. It appears no other SAFT signatory has expressed interest in controlling litigation against Defendants, a class would avoid the difficulty and expense of adjudicating up to seventy-six individual lawsuits, and the relatively small size of the proposed class is manageable.

Numerosity is likewise satisfied. The proposed seventy-six member class well exceeds the standard numerosity threshold. Also, while the other SAFT signatories may be capable of pursuing individual lawsuits, their geographical diversity and interests of judicial economy strongly favor adjudication as a class.

The Court would, moreover, find sufficient superiority and numerosity with only limited consideration of Defendants' *res judicata*-based challenge. For instance, because Plaintiff is a permanent resident of and currently resides in Nevada, Defendants do not identify a realistic concern as to the laws of Costa Rica. Nor does it appear there would be any serious concern with respect to, at least, the nine putative class members residing in the United Kingdom and Canada. *See, e.g.*, *Willcox*, 2016 WL 8679353, at *13 (Canadian courts " 'would more likely than not recognize and give preclusive effect to a judgment rendered' by a U.S. court.") (citations omitted); *Anwar v. Fairfield Greenwich Ltd.*, 289 F.R.D. 105, 115-17 (S.D.N.Y. 2013) ("[T]he courts of the United Kingdom, Canada, and other common law countries would more likely than not recognize, enforce, and give preclusive effect to any judgment rendered in this case[.]"), *vacated and remanded on other grounds sub nom. St. Stephen's Sch. v. PricewaterhouseCoopers Accts. N.V.*, 570 F. App'x 37 (2d Cir. 2014); *In re Alstom SA Sec. Litig.*, 253 F.R.D. at 282 (certifying class as to English, Dutch, and Canadian but not French putative class members); *In re Vivendi Universal*, 242 F.R.D. 76, 105 (S.D.N.Y. 2007) (certifying class as to French, English, and Dutch but not German or Austrian putative class members). Contrary to Defendants' contention that such a finding necessitates consideration of expert testimony, "[w]hen determining foreign law, courts 'may consider any relevant material or source,' including determinations by other courts." *Wilcox*, 2016 WL 8679353, at *13 (quoting Fed. R. Civ. P. 44.1). *Accord In re*

Alstom SA Sec. Litig., 253 F.R.D. at 291 (although often submitted, expert declarations "are not necessary for plaintiffs to carry their burden of establishing aspects of foreign law.") Considered as such, the proposed class would properly include and satisfy both the superiority and numerosity requirements with, at a minimum, forty-one members. *See* Dkt. 199, Ex. 28.

2. Commonality and Predominance:

Under Rule 23(a), there must be questions of law or fact common to the class. Fed. R. Civ. P. 23(a)(2). Class members' claims "must depend upon a common contention ... of such a nature that it is capable of classwide resolution – which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke." *Dukes*, 564 U.S. at 350. The Court looks to " 'the capacity of a class-wide proceeding to generate common *answers* apt to drive the resolution of the litigation.' " *Id.* (quoted source omitted).

The Rule 23(a)(2) test of commonality is generally subsumed by the predominance requirement under Rule 23(b)(3). *Georgine v. Amchem Prods., Inc.*, 83 F.3d 610, 627 (3d Cir. 1996), *aff'd sub nom. Amchem Prods., Inc. v. Windsor*, 521 U.S. 591 (1997). *See also Hanlon*, 150 F.3d at 1022 (the predominance analysis presumes the existence of common issues of fact or law under Rule 23(a)(3)). Predominance requires a showing "that the questions of law or fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). This factor "tests whether proposed classes are sufficiently cohesive to warrant adjudication by representation." *Amchem Products, Inc.*, 521 U.S. at 623. A central concern is "whether 'adjudication of common issues will help achieve judicial economy.' " *Vinole*, 571 F.3d at 944 (quoting *Zinser*, 253 F.3d at 1189).

***8** In considering predominance, the Court must carefully scrutinize the relationship between common and individual questions in a case. *Tyson Foods, Inc. v. Bouaphakeo*, 577 U.S. 442, 453 (2016). "An individual question is one where 'members of a proposed class will need to present evidence that varies from member to member,' while a common question is one where 'the same evidence will suffice for each member to make a prima facie showing [or] the issue is susceptible to generalized, class-wide proof.' " *Id.* (quoted source omitted).

The predominance analysis "begins, of course, with the elements of the underlying cause of action." *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804, 809 (2011). *Accord Jimenez v. Allstate Ins. Co.*, 765 F.3d 1161, 1165 (9th Cir. 2014) ("Whether a question will drive the resolution of the litigation necessarily depends on the nature of the underlying legal claims that the class members have raised.") "[M]ore important questions apt to drive the resolution of the litigation are given more weight in the predominance analysis over individualized questions which are of considerably less significance to the claims of the class." *Ruiz Torres v. Mercer Canyons Inc.*, 835 F.3d 1125, 1134 (9th Cir. 2016). When common questions present a " 'significant aspect' " of class members' claims and allow for resolution in a single adjudication, there is " 'clear justification' " for class treatment. *Hanlon*, 150 F.3d at 1022 (quoted source omitted).

Plaintiff pursues a claim under the WSSA. The WSSA makes it unlawful for any person to offer or sell a security unless it is registered or exempt. RCW 21.20.140. It imposes strict liability on any person who "offers or sells" unregistered, non-exempt securities, RCW 21.20.430(1), and on any person who "directly or indirectly controls a seller", "every partner, officer, director or person who occupies a similar status or performs a similar function", and any employees "who materially aid[ ] in the transaction," unless they can show they did not know and with exercise of reasonable care could not have known the facts giving rise to liability, RCW 21.20.430(3). *See also In re Jensen-Ames*, 2011 WL 1238929, at *9 (Bankr. W.D. Wash. Mar. 30, 2011) ("Washington law provides for strict liability where a person offers or sells a security without registration and in violation of RCW 21.20.140. RCW 21.20.430(1).")

Plaintiff argues that, given strict liability under the WSSA, common questions and answers predominate in this matter. The SAFTs signed by all putative class members were materially identical except for the date and value of investment and explicitly state that the SAFT is a security and has not been registered. *See, e.g.*, Dkt. 199, Ex. 29. Plaintiff intends to present evidence contradicting alleged exemptions

under SEC Rules 506(b) and (c), *see* 17 C.F.R. §§ 230.502(c) and 230.506(b)-(c), reflecting Defendants' communications and behavior, and answering questions common to the class. Likewise, for each individual Defendant, an affirmative defense would depend on that Defendant's actions, status, control, or constructive knowledge, and would concern his or her conduct with regard to the class as a whole. *See also* *Go2Net, Inc. v. Freeyellow.com, Inc.*, 126 Wn. App. 769, 782-83 109 P.3d 875 (2005) (equitable defenses are not available under the WSSA), *aff'd*, 158 Wash. 2d 247, 143 P.3d 590 (2006).

Plaintiff asserts the simplicity of calculating damages under RCW 21.20.430 as the cost of the ATMI tokens minus any offsetting remuneration, plus interest. He, finally, points to caselaw as reflecting application of the WSSA regardless of where purchasers reside, *see, e.g.*, *Ito Int'l Corp. v. Prescott, Inc.*, 83 Wn. App. 282, 289-90, 921 P.2d 566 (1996), thus avoiding any choice of law issue undermining predominance. *See* *Peterson v. Graoch Assocs. No. 111 Ltd. P'ship*, No. C11-5069-BHS, 2012 WL 254264, at *3 (W.D. Wash. Jan. 26, 2012) (denying motion to dismiss WSSA claim based on extraterritorial transactions and observing that "public policy favors the application of Washington law to ensure that Washington corporate entities behave responsibly.")

***9** Defendants argue individualized issues overwhelm any common issues and preclude findings of commonality and predominance, including: whether putative class members consented to binding arbitration through the Terms of Token Sale (hereinafter "Terms"); whether some SAFT signatories lack standing because they purchased ATMI tokens as a utility and therefore do not claim injury; whether a judgment in this matter would be enforceable in countries where the class members resided at the time they executed SAFTs; and consideration of Defendants' fact-based affirmative defenses. The Court disagrees with Defendants.

a. Arbitration:

Under Washington law, the existence of an agreement to arbitrate requires an objective manifestation of mutual assent. *Nicosia v. Amazon.com, Inc.*, 834 F.3d 220, 232 (2d Cir. 2016) (citations omitted). The party seeking to compel arbitration "bears 'the burden of proving the existence of an agreement to arbitrate by a preponderance of the evidence.' " *Norcia v. Samsung Telecomm. Am.*, 845 F.3d 1279, 1283 (9th Cir. 2017) (quoted source omitted).

In April 2020, the Court denied Defendants' motion to compel arbitration. Dkts. 40 & 66. The Court rejected the contention Plaintiff had actual or constructive notice of an arbitration agreement in the Terms merely because Defendants, months *after* Plaintiff entered into the SAFT, delivered an email containing a link to the Terms, or that Plaintiff assented to the Terms upon the later delivery of tokens. *See* Dkt. 40 at 18-22. There was no evidence Plaintiff opened the email and its attachment or did anything whatsoever after he signed the SAFT. Also, language in the Terms raised questions as to their applicability to SAFT investors. *Id.*

Defendants now suggest other SAFT signatories could have assented to the Terms. They point to Ninth Circuit law as precluding certification where class members executed potentially valid arbitration agreements or class action waivers. *See, e.g.*, *O'Connor v. Uber Techs., Inc.*, 904 F.3d 1087, 1094-95 (9th Cir. 2018) (reversing certification orders premised on a district court's finding that arbitration agreements were not enforceable following a ruling that the question of arbitrability was designated to the arbitrator). They identify necessary individualized inquiries into assent as including a class member's sophistication, when they received the Terms, and whether they opened the email and clicked on the link to the Terms.

Plaintiff proposes certification of a class that excludes anyone who "affirmatively assented" to the Terms. To the extent SAFT signatories affirmatively assented to the Terms, they are by definition not a part of the proposed class.

Defendants now reiterate their theory of manifestation of assent through actual or constructive notice of an arbitration clause upon the delivery of an email *after* class members entered into SAFTs. They do not identify evidence a SAFT signatory manifested assent in this or in any other manner, and Plaintiff attests Defendants produced no such evidence in response to discovery requests. *See* Dkt. 219 at 5-6 (citing Dkt. 220, Exs. B-D). There is, in other words, no evidence any member of the proposed class assented to arbitration and no more than speculation that evidence of actual or constructive notice of an arbitration clause could be found and could support the existence of a binding agreement to arbitrate.

Mere speculation does not suffice to defeat class certification. *Agne v. Papa John's Int'l, Inc.*, 286 F.R.D. 559, 567-568 (W.D. Wash. 2012). Because there is no evidence any SAFT signatory entered into a binding arbitration agreement, this matter bears no resemblance to cases in which Courts have found executed arbitration agreements to preclude class certification. *See, e.g.*, *Lawson v. Grubhub, Inc.*, No. 18-15386, —— F.4th ——, 2021 WL 4258826, at *5 (9th Cir. Sept. 20, 2021) (affirming denial of certification where all class members except the lead plaintiff and one other person entered into arbitration agreements and class action waivers, and the record was clear class members "waived the right 'to have any dispute or claim brought between or among them, [or] heard or arbitrated as a class action.' "); *O'Connor*, 904 F.3d at 1093-95 (addressing arbitration agreements plaintiff alleged were unenforceable based on opt out provisions and the legality of class action waivers); *Renton v. Kaiser Found. Health Plan, Inc.*, C00-5370-RJB, 2001 WL 1218773, at *5 (W.D. Wash. Sept. 24, 2001) (finding argument that arbitration agreements of some "three-fourths of [ ] eight million" putative class members were not valid or enforceable "an unresolved issue whose determination may vary from state to state and from district to district.") *See also Andersen v. Briad Rest. Grp., LLC*, 333 F.R.D. 194, 207 (D. Nev. 2019) (plaintiff did not deny over half of potential class members were "likely subject to arbitration" and instead defined the class to exclude those who " 'executed enforceable arbitration agreements.' "; court modified class definition by removing the term "enforceable" and thereby avoided the need for individualized mini-trials on enforceability).

b. Purpose of ATMI tokens:

***10** Defendants maintain a SAFT signatory's understanding or intent with regard to the purpose of ATMI tokens presents the need for individualized inquiry. To the contrary, because the WSSA imposes strict liability for the sale of unregistered, non-exempt securities, a showing that Defendants violated the statute would determine liability and compel restitution as to the entire class, regardless of whether any individual considered the token to have use as a utility.

c. Enforceability of a judgment:

Defendants assert the need to conduct a "case-by-case analysis" of the enforceability of a judgment from this Court for each country where class members resided when they executed SAFTs. Dkt. 208 at 17. The Court finds this inquiry unnecessary for the reasons discussed above. It also appears to be undisputed that, if found liable under the WSSA, the judgment would be enforceable against Defendants regardless of where class members resided when they entered into SAFTs. *Peterson*, 2012 WL 254264, at *3; *Ito Int'l Corp.*, 83 Wn. App. at 289-90.

d. Affirmative defenses:

Defendants argue individualized analyses of their fact-based affirmative defenses will overwhelm any common issues. Specifically, they assert the need to evaluate accredited investor status and factual circumstances of accreditation, knowledge, and experience for each SAFT signatory in order to determine whether a Rule 506(b) or (c) exemption applies.

"Defenses that must be litigated on an individual basis can defeat class certification." *True Health Chiropractic, Inc. v. McKesson Corp.*, 896 F.3d 923, 931 (9th Cir. 2018). But " '[w]hen one or more of the central issues in the action are common to the class and can be said to predominate, the action may be considered proper under Rule 23(b)(3) even though other important matters will have to be tried separately, such as damages or some affirmative defenses peculiar to some individual class members.' " *Tyson Foods*, 577 U.S. at 453 (quoted source omitted). *See also* 2 Newberg on Class Actions § 4:55 (5th ed.) (" '[C]ourts traditionally have been reluctant to deny class action status under Rule 23(b)(3) simply because affirmative defenses may be available against individual members.' ") (quoted sources omitted). When analyzing whether an affirmative defense must be litigated on an individual basis, the Court considers the affirmative defenses the Defendants have "actually advanced and for which it has presented evidence." *True Health Chiropractic, Inc.*, 896 F.3d at 931. The Court here agrees with Plaintiff that individualized, exemption-based inquiries into the status of each SAFT investor will not be necessary.

i. Rule 506(b):

Rule 506(b) exempts securities where "[e]ach purchaser who is not an accredited investor ... has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes immediately prior to making any sale that such purchaser comes within this description." 17 C.F.R. § 230.506(b). To have "safe harbor" under Rule 506(b), "neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising[.]" 17 C.F.R. § 230.502(c). Plaintiff points to the evidence as showing Defendants publicly and widely advertised and solicited investors for both the SAFT and public sale stages of the ICO, *see* Dkt. 197 at 4-6, 16, rendering the Rule 506(b) exemption inapplicable. As Plaintiff observes, regardless of whether the evidence establishes general solicitation or advertising as a matter of law, the answer to this question will be common to the class.

***11** In addition, and as discussed below, Plaintiff maintains the two-part ICO was an integrated offering, a showing of which would necessarily preclude exemption under Regulation D. Defendants also acknowledge "[e]very prospective investor completed an 'Investor Questionnaire' to attest to their accreditation status and financial sophistication[,]" and that a third party "conducted a robust accreditation verification process that included authentication of all documents provided by prospective investors, facial recognition, and watch list database searches." Dkt. 208 at 4-5 (citing Dkt. 50-2, Ex. B, and Dkt. 50, ¶31). This undermines Defendants' contention individualized inquiries will necessarily be required for each class member. Even if *some* inquiry in relation to *some* investors is required, there is no basis for concluding it would override the common questions and answers that predominate in this matter. The Court's conclusion regarding predominance thus remains the same even assuming Plaintiff fails to establish general solicitation or advertising.

ii. Rule 506(c):

Rule 506(c) exempts securities from registration if all purchasers are accredited investors, the issuer takes reasonable steps to verify purchasers' accredited investor status, the issuer does not have knowledge that any purchaser is not an accredited investor, and the issuer meets other requirements, including Rule 502(d)'s requirement to exercise reasonable care to ensure purchasers are not underwriters. 17 C.F.R. § 203.506(c). Plaintiff contends that, as recently found in a similar case involving a SAFT and public sale of tokens, the SAFT and public sale in this case were sub-parts of a single "integrated offering" and that the sale of securities to 14,000 unaccredited investors necessarily removes the SAFT from any safe harbor. *U.S. Sec. & Exch. Comm'n v. Kik Interactive Inc.*, 492 F. Supp. 3d 169, 181-82 (S.D.N.Y. 2020) (if the private pre-sale and the public sales "are considered part of the same offering, the [p]re-Sale does not qualify for an exemption under [Rule 506(c)] of Regulation D.") *See also* *SEC v. Telegram Grp. Inc.*, 448 F. Supp. 3d 352, 367-68 (S.D.N.Y. 2020) (rejecting depiction of two distinct sets of transactions, first through allegedly exempt token "Purchase Agreements", followed by sale of the tokens themselves), *request for clarification denied*, 2020 WL 1547383, at * 1 (S.D.N.Y. Apr. 1, 2020) ("[T]he 'security' was neither the Gram Purchase Agreement nor the Gram but the entire scheme that comprised the Gram Purchase Agreements and the accompanying understandings and undertakings made by Telegram[.]"), *appeal withdrawn* at 2020 WL 3467671 (2d Cir. May 22, 2020).

Factors relevant to finding an integrated offering include whether the sales were part of a single plan of financing, involved issuance of the same class of securities, were made at or about the same time, entailed receipt of the same type of consideration, and were made for the same general purpose. *Kik Interactive Inc.*, 492 F. Supp. 3d at 181 (while different forms of consideration were received, the private and public sales were part of a single financing plan, proceeds went to the same purpose, the seller did not differentiate between funds raised, private sale participants could receive tokens only with a successful public sale, all purchasers received fungible tokens equal in value, the pre-sale ended the day before the public sale, and tokens were distributed at the same time). Plaintiff points to the record in this case as containing evidence of an integrated offering similar to that in *Kik Interactive Inc.* and focusing on Defendants' acts and behavior. *See* Dkt. 197 at 17 (evidence showing internal consideration of the ICO as a single fundraising event, that both segments sold ATMI tokens, that the public sale occurred shortly after execution of the second round of SAFTs, and that both segments sold tokens for ETH). A finding in Plaintiff's favor on this issue would apply equally to the entire class and preclude safe harbor under Rule 506(c).

***12** Predominance would also exist even assuming the absence of an integrated offering. Safe harbor under Rule

506(c) requires that *all* purchasers are accredited investors, reasonable steps to verify accreditation, and that the issuer had no knowledge an investor was not accredited. 17 C.F.R. § 203.506(c). Plaintiff points to the record as showing Defendants knew " 'syndicates' " or groups were investing through a SAFT by filling out a single accreditation questionnaire and without proper verification by Defendants. *See* Dkt. 219 at 8 (citing Dkt. 220, Ex. A at 1; Dkt. 59 at 7:5-12; Dkt. 96 at 4:2-11). Because all investors must be accredited, a showing that even one SAFT signatory was not accredited would preclude exemption under Rule 506(c). The Court, as such, rejects the contention individualized Rule 506(c) inquiries would overwhelm questions common to the class.

e. Common questions predominate:

The proposed class signed the same SAFT and their claims involve the common questions of whether the SAFT is a security, was not registered, does not satisfy an exemption, and was part of an integrated offering with another non-exempt, unregistered security. If Plaintiff succeeds in showing Defendants sold unregistered, non-exempt securities and are therefore jointly and severally liable under the WSSA, each class member will have suffered the same type of injury, caused by the same course of conduct. Also, to the extent any individual Defendant seeks to show he or she did not know and with exercise of reasonable care could not have known facts giving rise to liability, *see* RCW 21.20.430(3), the resulting answer will depend on that individual's actions, status, control, or constructive knowledge and the determination of liability will be common to all class members. Nor do Defendants refute Plaintiff's contention of the simplicity of calculating damages for each class member. The Court, for these reasons and for the reasons stated above, concludes that questions common to class members predominate over any individualized inquiries.

3. Typicality:

The typicality requirement is met if the named plaintiff's "claims or defenses ... are typical of the claims or defenses of the class." Fed. R. Civ. P. 23(a)(3). This requirement serves to "assure that the interest of the named representative aligns with the interests of the class." *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 508 (9th Cir. 1992). Representative claims need only be "reasonably co-extensive with those of the absent class members; they need not be substantially identical." *Hanlon*, 150 F.3d at 1020. "The test of typicality is whether other members have the same or similar injury, whether the action is based on conduct which is not unique to the named plaintiffs, and whether other class members have been injured by the same course of conduct." *Ellis v. Costco Wholesale Corp.*, 657 F.3d 970, 984 (9th Cir. 2011) (cleaned up and citations omitted). "Typicality refers to the nature of the claim or defense ... not to the specific facts from which it arose or the relief sought." *Id.*

Defendants assert Plaintiff is not typical of the class to the extent other class members may have assented to the Terms and are bound to an arbitration clause and class action waiver. This argument fails for the reasons discussed above in relation to predominance. Defendants also assert their counterclaims make Plaintiff unfit to represent other class members' interests. Because the Court finds those counterclaims should be dismissed, *see* Dkt. 218, this argument similarly fails to preclude a finding of typicality. The counterclaims would not, in any event, preclude strict liability under the WSSA to both Plaintiff and the class.

Plaintiff, like all putative class members, signed a standardized SAFT prepared by Atonomi, paid ETH in exchange for ATMI tokens, and alleges joint and several liability of Defendants for the sale of unregistered, non-exempt securities in violation of the WSSA. Plaintiff is typical of the class in suffering the same type of injury, based on the same course of conduct, and alleging the same basis for liability.

4. Adequacy:

***13** The adequacy requirement asks whether the class representative "will fairly and adequately protect the interests of the class." Fed. R. Civ. P. 23(a)(4). It serves to uncover conflicts of interest between named parties and the class they seek to represent. *Windsor*, 521 U.S. at 625 (citing *Gen. Tel. Co. of Sw. v. Falcon*, 457 U.S. 147, 157-58 n.13 (1982)). A finding of adequacy requires resolution of two questions: " '(1) do the named plaintiffs and their counsel have any conflicts of interest with other class members and (2) will the named plaintiffs and their counsel prosecute the action vigorously on behalf of the class?' " *In re Hyundai & Kia Fuel Econ. Litig.*, 926 F.3d 539, 566 (9th Cir. 2019) (quoted source omitted).

Defendants point to their counterclaims as preventing a finding of adequacy. They assert Plaintiff's alleged breach of the SAFT, and the resulting counterclaims, constitute a clear and disqualifying conflict of interest with the class that necessarily precludes certification. *See, e.g.*, *Knudsvig v. Espresso Stop, Inc.*, C06-1559-RSM, 2007 WL 2253371, at *2 (W.D. Wash. Aug. 1, 2007) (finding no typicality with defendants' showing the named plaintiffs would be "substantially preoccupied with their defenses to counterclaims, which are unique to them[ ]" and would divert their focus from the claims of the class); *Grace v. Perception Tech. Corp.*, 128 F.R.D. 165, 170 (D. Mass. 1989) (finding no adequacy where defendants' counterclaim could make the named plaintiffs liable to class members for part of the losses, went to the subject matter of the suit, and was an immediate and obvious substantial conflict of interest).

Class certification may be precluded where the "named plaintiff is subject to unique defenses that will be a major focus of the litigation." *Hanon*, 976 F.2d at 508. However, "[t]he mere existence of a counterclaim does not preclude class certification." *Ballard v. Equifax Check Servs., Inc.*, 186 F.R.D. 589, 595 (E.D. Cal. 1999). "It is only where a counterclaim raises a conflict between the interests of the named plaintiff and the absent class members that causes adequacy of representation to be lacking." *Id.* at 596. If otherwise, every motion for class certification would be defeated simply by the filing of a counterclaim. *Id.* at 595-96.

In this case, the Court has recommended dismissal of the counterclaims. Given that recommendation, and the absence of any showing as to a real and substantial conflict of interest between Plaintiff and the proposed class, the counterclaims do not undermine adequacy.

The Court finds Plaintiff, as an individual who signed a SAFT, paid ETH valued at $191,250 for ATMI tokens, and seeks damages for his losses, to have interests properly aligned with the class and motivated to establish liability and obtain maximum recovery. Plaintiff's representatives, who have actively prosecuted this matter since April 2019, negotiated a class-wide settlement with three named Defendants, *see* Dkts. 190 & 205, and have the pertinent expertise, Dkt. 199, Exs. 50-52, lack any apparent conflict of interest and have demonstrated their willingness to vigorously prosecute this action on behalf of the class. Plaintiff, accordingly, also satisfies the adequacy requirement.

CONCLUSION

For the reasons discussed above, Plaintiff's Motion for Class Certification, Dkt. 197, should be GRANTED. The Court should certify the proposed class and appoint Plaintiff as Class Representative and his representatives as Class Counsel. A proposed order accompanies this Report and Recommendation.

OBJECTIONS

***14** Objections to this Report and Recommendation, if any, should be filed with the Clerk and served upon all parties to this suit within **fourteen (14) days** of the date on which this Report and Recommendation is signed. Failure to file objections within the specified time may affect your right to appeal. Objections should be noted for consideration on the District Judge's motions calendar for the third Friday after they are filed. Responses to objections may be filed within **fourteen (14)** days after service of objections. If no timely objections are filed, the matter will be ready for consideration by the District Judge on **December 3, 2021**.

All Citations

Slip Copy, 2021 WL 5858811

Footnotes

1 For brevity, the Court refers to the Defendants proceeding in opposition to the motion for class certification as "Defendants", rather than "Non-Settling Defendants."

2 Defendants also cite to inapposite cases relating to the extraterritorial application of United States law. *Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247, 267 (2010) (Securities Exchange Act applies only to the "purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States."); *Barron v. Helbiz Inc.*, C20-4703, 2021 WL 229609, at *6 (S.D.N.Y. Jan. 22, 2021) (dismissing claims without prejudice to renewal in other jurisdictions where an ICO for a token "was of a security which was not listed on a United States exchange or purchased in the United States.") Those cases do not preclude the inclusion of foreign investors in a class raising a challenge to a domestic law. *See, e.g.*, *Vinh Nguyen v. Radient Pharm. Corp.*, 287 F.R.D. 563, 575 (C.D. Cal. 2012) ("[T]his case is about federal securities laws, and even if the case 'can essentially include individuals from all over the world,' Section 10(b) of the Securities Exchange Act applies to securities bought from an American stock exchange, regardless of the location of the investor.") (citations omitted).

End of Document

TAB 36

Atwal v. NortonLifeLock, Inc., Case No. 20-CV-449S (W.D.N.Y.) 2022 WL 327471

2022 WL 327471
Only the Westlaw citation is currently available.
United States District Court, W.D. New York.

Ephraim ATWAL, M.D., Plaintiff,
v.
NORTONLIFELOCK, INC., Defendant.

20-CV-449S
|
Signed 02/03/2022

Attorneys and Law Firms

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DECISION AND ORDER

WILLIAM M. SKRETNY, United States District Judge

I. Introduction

***1** This is a removed diversity action for breach of contract. Plaintiff is a New York doctor and Defendant NortonLifeLock is a Delaware corporation with its principal place of business in Arizona (Docket No. 1, Notice of Removal ¶¶ 7.a., 7). NortonLifeLock issued Plaintiff a policy for identity loss protection (see Docket No. 1, Notice of Removal, Ex. A, Compl. ¶ 14, Ex. A). Plaintiff alleges that Defendant breached its contract by not covering his losses from his cryptocurrency account after a third-party stole his credentials to that account and looted it (see id. ¶¶ 9-10, 12, 22-24).

Before this Court is Defendant's Motion to Dismiss (Docket No. 6 [1]). This Court concludes that Plaintiff alleges a breach of Defendant's Policy. For the reasons stated below, this Motion is granted in part (dismissing the Third Cause of Action for breach of the duty of good faith and fair dealing and Fourth Cause of Action for unjust enrichment) and denied in part (upholding the First Cause of Action for declaratory judgment and Second Cause of Action for breach of contract). Therefore, Plaintiff shall file an Amended Complaint within twenty-one (21) days of entry of this Order. Defendant shall file its Answer or Motion within fourteen (14) days of service of the Amended Complaint.

II. Background

A. Plaintiff's Cryptocurrency Account

From June 26, 2017, Plaintiff maintained a private EOS [2] cryptocurrency account, operating on blockchain technology and accessible through private key credentials (Docket No. 1, Notice of Removal, Ex. A, Compl. ¶¶ 7-8). On or about August or September 2018, a third-party misappropriated his key credentials and stole all of Plaintiff's EOS funds in his cryptocurrency account (id. ¶¶ 9-10; see also id. ¶ 12 (unauthorized use of key credentials)). Plaintiff alleges that approximately 2.09 million EOS funds (valued at approximately $12 million USD) were in his account prior to the misappropriation (id. ¶ 11). Plaintiff unsuccessfully sought to recover the account's funds from cryptocurrency exchanges where the unauthorized third-party transferred his EOS funds (id. ¶ 13).

B. Defendant's LifeLock Identify Theft Program

On or about July 11, 2018, Defendant issued Plaintiff a LifeLock Ultimate Plus policy for a one-year period (id. ¶ 14, Ex. A, "Certificate of Insurance Stolen Identity Event Insurance," hereinafter the "Policy"). Pursuant to the Policy, Defendant agreed to pay up to $1 million coverage for remediation, stolen funds reimbursement, personal expenses, and coverage for lawyers and experts for a "Stolen Identity Event" (id. ¶ 16, Ex. A, Policy at 3).

***2** A "Stolen Identity Event" is defined in the Policy as a theft of personal information without the insured's express authorization to establish or use a deposit, credit, or other Account (id. ¶ 20, Ex. A, Policy § VI., Definitions U., "Stolen Identity Event," at 10). That personal information includes "personal identification, social security number, or other method of identifying you, or one or more uses of such stolen information without your express authorization to establish or use a deposit, credit or other Account, secure a loan, ... enter into a contract or commit a crime" (Docket No. 1, Ex. A, Compl. Ex. A, Policy § VI., Definitions U., at 10 (emphasis added)).

A covered victim of a Stolen Identity Event also may obtain remediation coverage from Defendant including reimbursement of stolen funds, remediation coverages, and

coverage of "direct financial loss arising from a Stolen Funds Loss incurred as a direct result of a Stolen Identity Event" (id. ¶ 17, Ex. A, Policy § I.C., at 4-5, ¶ 18, Ex. A, Policy § I.B., at 4). "Stolen Funds Loss," in turn, is defined in this Policy as "the principal amount, incurred by [the insured] and caused by an Unauthorized Funds Transfer" (id. ¶ 19, Ex. A, Policy § VI., Definitions T., "Stolen Funds Loss," at 10). "Unauthorized Funds Transfer" means "a Funds Transfer from your Account initiated by a person other than [the insured] without the actual authority to initiate the transfer and from which you and your immediate family members receive no benefit" (id., Ex. A, Policy § VI., Definitions X., "Unauthorized Funds Transfer," at 10).

C. Plaintiff Requests Coverage

Plaintiff alleges that he sought reimbursement on May 24 and June 21, 2019 (Docket No. 1, Ex. A, Compl. ¶¶ 22, 23), but on July 18 and November 18, 2019, Defendant denied Plaintiff's claim (id. ¶ 24). As of the filing of this action, Defendant has not paid this claim (id. ¶ 25).

Defendant argues that Plaintiff's claimed account is not a defined "Account" under its Policy (Docket No. 6, Def. Memo. at 3-5). Under Defendant's Policy, an "Account"

> "is defined as 'a U.S. regulated and domiciled checking, savings, money market, brokerage, or credit card Account of yours held directly or indirectly by a Financial Institution and established primarily for personal, family or household purposes. 'Account' also includes a Retirement Account held in your name, or the name of your authorized representative."

(Id. at 3; Docket No. 1, Ex. A, Compl. Ex. A, Policy § VI., Definitions B., "Account," at 9 (emphasis added)). This "Account" applies to aspects of the Policy (e.g., Docket No. 1, Ex. A, Policy § VI., Definitions U., X.). "Financial Institution," in turn, is defined as a "bank, savings, association, credit union, credit institution or company issuing credit or any other person or entity that directly or indirectly holds an Account belonging to you" (id., Ex. A, Compl. Ex. A Policy § VI., Definitions G., at 9; see Docket No. 9, Pl. Memo. at 9). The Policy limits the coverage territory to pay losses "incurred in the United States or a branch or office abroad of a United States regulated Financial Institution" (Docket No. 1, Ex. A, Compl., Ex. A, Policy § VIII. C., at 11).

D. Complaint, Removal, and Defendant's Motion to Dismiss

Plaintiff initially sued Defendant in New York State Supreme Court, Erie County (Docket No. 1, Notice of Removal, ¶ 1, Ex. A, Compl. (Index No. 803782/2020), alleging four causes of action (Docket No. 1, Ex. A). The First Cause of Action seeks declaratory judgment that Plaintiff was entitled to coverage from Defendant under the Policy (id. ¶¶ 28-30). The Second Cause of Action alleges breach of contract for failing to cover Plaintiff's loss (id. ¶¶ 32-36). The Third Cause of Action claims breach of the implied covenant of good faith and fair dealing (id. ¶¶ 38-41) and the Fourth Cause of Action alleges Defendant's unjust enrichment (id. ¶ 43). Plaintiff claims suffering damages he valued at least $80,000 (id. ¶¶ 36, 41, 43, WHEREFORE Cl., b)).

***3** Defendant removed this action (Docket No. 1) and a month later filed the pending Motion to Dismiss (Docket No. 6). This Court deems this Motion to be submitted without oral argument.

III. Discussion

A. Applicable Standards

1. Motion to Dismiss

Defendant has moved to dismiss on the grounds that the Complaint fails to state a claim for which relief can be granted (id.). Under Rule 12(b)(6), the Court cannot dismiss a Complaint unless it appears "beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." Conley v. Gibson, 355 U.S. 41, 45-46, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957). As the Supreme Court held in Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007), a Complaint must be dismissed pursuant to Rule 12(b)(6) if it does not plead "enough facts to state a claim to relief that is plausible on its face," id. at 570, 127 S.Ct. 1955 (rejecting longstanding precedent of Conley, supra, 355 U.S. at 45-46, 78 S.Ct. 99).

To survive a motion to dismiss, the factual allegations in the Complaint "must be enough to raise a right to relief above the speculative level," Twombly, supra, 550 U.S. at 555, 127

S.Ct. 1955; Hicks, supra, 2007 U.S. Dist. LEXIS 39163, at *5. As reaffirmed by the Court in Ashcroft v. Iqbal, 556 U.S. 662, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009),

> "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' [Twombly, supra, 550 U.S.] at 570, 127 S.Ct. 1955 .... A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged. Id., at 556, 127 S.Ct. 1955 .... The plausibility standard is not akin to a 'probability requirement,' but it asks for more than a sheer possibility that a defendant has acted unlawfully. Ibid. Where a complaint pleads facts that are 'merely consistent with' a defendant's liability, it 'stops short of the line between possibility and plausibility of "entitlement to relief.' " Id., at 557, 127 S.Ct. 1955 ... (brackets omitted)."

Iqbal, supra, 556 U.S. at 678, 129 S.Ct. 1937 (citations omitted).

A Rule 12(b)(6) motion is addressed to the face of the pleading. The pleading is deemed to include any document attached to it as an exhibit, Fed. R. Civ. P. 10(c), such as Defendant's Policy (Docket No. 1, Ex. A, Compl. Ex. A), or any document incorporated in it by reference. Goldman v. Belden, 754 F.2d 1059 (2d Cir. 1985).

In considering such a motion, the Court must accept as true all the well pleaded facts alleged in the Complaint. Bloor v. Carro, Spanbock, Londin, Rodman & Fass, 754 F.2d 57 (2d Cir. 1985). However, conclusory allegations that merely state the general legal conclusions necessary to prevail on the merits and are unsupported by factual averments will not be accepted as true. New York State Teamsters Council Health and Hosp. Fund v. Centrus Pharmacy Solutions, 235 F. Supp. 2d 123 (N.D.N.Y. 2002).

2. Choice of Law

As a removed diversity action, the procedures are governed by federal law and rules, while the substantive law is governed by state law, see Erie R.R. v. Tompkins, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938); Ocean Ships, Inc. v. Stiles, 315 F.3d 111, 116 n.4 (2d Cir. 2002). A federal court sitting in diversity applies the choice of law rules from the state in which it sits. Klaxon v. Stentor Elec. Mfg. Co., 313 U.S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941).

***4** Neither party disputes that New York law governs here. Defendant's Policy declares that New York law applies to any disputes arising under the Policy (Docket No. 1, Ex. A, Compl. ¶ 21, Ex. A, Policy VIII., Common Policy Conditions E., at 12 (choice of law provision)). New York courts will enforce a contractual choice-of-law clause like the Policy here so long as the chosen law bears a reasonable relationship to the parties or the transaction. National Traffic Serv., Inc. v. Fiberwell, Inc., 829 F. Supp.2d 185, 188 (W.D.N.Y. 2011) (Skretny, C.J.), citing Aramarine Brokerage, Inc. v. OneBeacon Ins. Co., 307 F. App'x 562, 564 (2d Cir. 2009). Since this Policy provides identity theft protection, choice of the law of the insured's forum is reasonable.

3. Cryptocurrency

Whether Plaintiff has an "Account" covered by Defendant's Policy depends upon whether Plaintiff's EOS cryptocurrency account falls under the Policy's definition of a domestic regulated "Account" (Docket No. 1, Ex. A, Compl., Ex. A, Policy § VI., Definitions B., at 9).

As Defendant observes (Docket No. 6, Def. Memo. at 4), cryptocurrency (such as EOS or Bitcoin) currently is not legal tender, Tucker v. Chase Bank USA, N.A., 399 F. Supp.3d 105, 108 (S.D.N.Y. 2019), see also id. at 112-13 (parties' definitions of "cash-like transaction," arguing that "cash" meant fiat currency); Lagemann v. Sence, No. 18 Civ. 12218, 2020 WL 5754800, at *2 n.3 (S.D.N.Y. May 18, 2020); In re Mt. Gox Bitcoin Exchange Litig., 291 F. Supp.3d 1370, 1370 n.2 (J.P.M.L. 2018) (in denial of transfer to Multidistrict Litigation court, finding that Bitcoin operates without a central bank or single administrator); Wisconsin Central Ltd. v. United States, 585 U.S. ——, 138 S.Ct. 2067, 2076, 201 L.Ed.2d 490 (2018) (Breyer, J., dissenting) ("Moreover, what we view as money has changed over time.... perhaps one day employees will be paid in Bitcoin or some other type of cryptocurrency," citations omitted). It is a medium of exchange like cash but not issued or regulated by a sovereign power, United States v. Petix, No. 15CR227, 2016 WL

7017919, at *5 (W.D.N.Y. Dec. 1, 2016) (Scott, Mag. J.) (in Report & Recommendation, explaining Bitcoin was not "money" under 18 U.S.C. § 1960). Cryptocurrency is "computer files generated through a ledger system that operates on" blockchain technology, id. at *5 (citing Shahla Hazratjee, Bitcoin: The Trade of Digital Signatures, 41 T. Marshall L. Rev. 55, 59 (2015)); see Lagemann, supra, 2020 WL 5754800, at *2 n.3 (although certain types of cryptocurrencies may be used as currency, cryptocurrencies are fundamentally private sector technologies, computer codes, and software applications) (quoting Tucker, supra, 399 F. Supp.3d at 108) (see Docket No. 1, Notice of Removal, Ex. A, Compl. ¶ 7). As observed about Bitcoin, the whole point of cryptocurrency "is to escape any entanglement with sovereign governments," Petix, supra, 2016 WL 7017919, at *5. Cryptocurrencies "have value exclusively to the extent that people at any given time choose privately to assign them value. No governmental mechanisms assist with valuation or price stabilization," id.

Despite Defendant's argument (cf. Docket No. Def. Reply Memo. at 4 & n.3), if not regulated by the Federal Deposit Insurance Corporation cryptocurrency may be traded as securities or commodities, U.S. Sec. & Exch. Comm'n v. Kik Interactive Inc., 492 F. Supp.3d 169, 177-82 (S.D.N.Y. 2020) (securities); Williams v. KuCoin, No. 20-CV-2806, 2021 WL 5316013, at *2 (S.D.N.Y. Oct. 21, 2021) (Lehrburger, Mag. J.) (Report & Rec.) (in 2019, Securities and Exchange Commission issued "Framework for 'Investment Contract' Analysis of Digital Assets" stating four prongs in determining whether a digital asset was a security); see In re Bibox Group Holdings, supra, 534 F. Supp.3d at 331 (in 2019, the SEC concluded that EOS issued by Block.one was a security under the 1933 Securities Act); Commodity Futures Trading Comm'n v. McDonnell, 287 F. Supp.3d 213, 228 (E.D.N.Y. 2018) (Weinstein, J.) (commodities) (Docket No. 9, Pl. Memo. at 8, 9 & n.5). In CFTC v. McDonnell, Judge Jack Weinstein held that

> ***5** "Virtual currencies can be regulated by CFTC as a commodity. Virtual currencies are 'goods' exchanged in a market for a uniform quality and value. Mitchell Prentis, Digital Metal: Regulating Bitcoin As A Commodity, 66 Case W. Res. L. Rev. 609, 626 (2015). They fall well-within the common definition of 'commodity' as well as the [Commodity Exchange Act's] definition of 'commodities' as 'all other goods and articles ... in which contracts for future delivery are presently or in the future dealt in.' Title 7 U.S.C. § 1(a)(9)."

Id. (emphasis added).

Securities regulation arises in the cited cases from the public sale of digital assets, Kik Interactive, supra, 492 F. Supp.3d at 174, 177-82; In re Bibox Group Holdings, supra, 534 F. Supp.3d at 331; Williams, supra, 2021 WL 5316013, at *2; see also 15 U.S.C. § 77e(a) (prohibition of sales in interstate commerce or the mails of unregistered securities). In Kik Interactive, defendant Kik Interactive conducted a private initial offering of Kin tokens with advice to buyers that the instrument they purchased was a security but not registered under any nation's securities laws, id. at 181-82. The district court held that the private pre-sale of the Kin tokens was a part of an integrated offering followed by the public sale of the tokens, 492 F. Supp.3d at 181-82. The court concluded that this private pre-sale and public offering of defendant's Kin tokens was a public sale of securities requiring a registration statement, id. at 177-82.

This conclusion, that a public sale of cryptocurrency is the sale of securities regulated under the Securities Act, however, postdates Plaintiff's present claim and occurred during the time of Defendant's denials of coverage. There is no allegation here of any public purchase or sale of Plaintiff's EOS cryptocurrency or public registration of the cryptocurrency.

Plaintiff alleges his EOS cryptocurrency is a private asset not in a government-regulated account, declaring that he "maintained a private EOS cryptocurrency account" (Docket No. 1, Ex. A, Compl. ¶ 7).

Defendant's Policy insured traditional currency accounts held by recognized institutions rather than the novel and evolving area of cryptocurrencies.

Absent allegation of government regulation generally applicable for fiat money, cryptocurrency like Plaintiff's EOS here is dependent upon the agreed upon definition of the parties. Defendant could (as it did here under the Policy) limit its coverage to domestic, regulated accounts only. By becoming a member, Dr. Atwal agreed to this limited scope of Defendant's coverage. Defendant thus could conclude that Plaintiff's EOS cryptocurrency is not from a domestic, regulated "Account" for coverage under its Policy.

B. First and Second Causes of Action—Declaratory Judgment and Breach of Contract

This Court will consider together Plaintiff's First and Second Causes of Action (cf. Docket No. 6, Def. Memo. at 3-5; Docket No. 9, Pl. Memo. at 5-12). In these claims, Plaintiff seeks declaratory judgment that Defendant breached its contract by not covering his loss of cryptocurrency and he seeks to recover damages for that breach.

1. Applicable Standard—Declaratory Judgment

Upon removal to this Court, federal procedures (including those for declaratory judgment) apply, see 28 U.S.C. § 1447(a). Under § 2201(a), where there is an actual controversy within this Court's jurisdiction, "upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree," 28 U.S.C. § 2201(a).

2. Breach of Contract under New York Law

***6** To state a breach of contract under New York common law, Plaintiff must prove, by preponderance of evidence, the existence of a contract with Defendant, performance of his obligations under the contract, breach of the contract by Defendant, and damages to Plaintiff caused by Defendant's breach, e.g., Diesel Props S.r.l. v. Greystone Business Credit II LLC, 631 F.3d 42, 52 (2d Cir. 2011) (citing cases) (Docket No. 37, Def. Memo. at 8); Acquest Holdings, Inc. v. Travelers Cas. & Sur. Co., 217 F. Supp.3d 678, 686 (W.D.N.Y. 2016) (Wolford, J.).

3. Parties' Contentions

Defendant contends that Plaintiff merely lost from an unregulated cryptocurrency account which was not an "Account" covered under its identity theft program (Docket No. 6, Def. Memo. at 1). Plaintiff's cryptocurrency is not subject to control or oversight of any governmental agency (id. at 3-4). Thus, Plaintiff's EOS cryptocurrency account was not an "Account" under Defendant's Policy because its "Account" only consisted of legal tender (id. at 4) and not Plaintiff's private EOS cryptocurrency (id.; see Docket No. 10, Def. Reply Memo. at 2). Therefore, Defendant concludes that Plaintiff failed to state a claim under its Policy (Docket No. 6, Def. Memo. at 3-5). Even if Plaintiff's alleged his loss is covered by Defendant's policy, Defendant retorts that Plaintiff has not incurred damages that would be covered (Docket No. 6, Def. Memo. at 5).

Plaintiff argues he incurred a "Stolen Identity Event" under Defendant's Policy either from the theft of Dr. Atwal's personal information or the subsequent plundering of his EOS cryptocurrency account (Docket No. 9, Pl. Memo. at 5-7; see Docket No. 1, Ex. A, Compl., Ex. A, Policy § VI., Definitions U., at 10). Furthermore, Plaintiff points out that cryptocurrency can be purchased as a commodity and that commodities are subject to regulation (Docket No. 9, Pl. Memo. at 8, 9 & n.5, citing CFTC v. McDonnell, supra, 287 F. Supp.3d at 228).

Further, Plaintiff responds that he pled entitlement to reimbursement and remediation coverage under Defendant's policy when someone misappropriated his credentials to his private EOS account (id. at 5-9). Plaintiff claims he alleged he had an "Account" as defined under Defendant's Policy or, if the language is ambiguous, it must be interpreted in his favor (id. at 6). Defendant's policy establishes two different occurrences for a "Stolen Identity Event" and Plaintiff points to the first occurrence, the theft of insured's personal information (id.; Docket No. 1, Ex. A, Compl., Ex. A, Policy § VI., Definitions U., "Stolen Identity Event," at 10) which did not require an "Account" as defined in the Policy (Docket No. 9, Pl. Memo. at 6). Plaintiff claims that his private credentials were his personal information covered by Defendant's policy (id. at 7). Plaintiff disputes whether his EOS account was regulated and domiciled in the United States (id. at 8). Plaintiff claims his EOS account is a brokerage account and thus under Defendant's policy (id. at 9).

Plaintiff next claims he pled entitlement to Fraudulent Withdrawal Coverage under Defendant's policy for suffering a Stolen Fund Loss (id. at 10). He also claims he pled damages under Defendant's policy (id. at 10-12).

In reply, Defendant contends that the private EOS account was not covered under its Policy because Account is defined as "U.S. regulated **and** domiciled checking, savings, money market, brokerage, or credit card Account of yours" (Docket

No. 10, Def. Reply Memo. at 2, emphasis in original). For a "Stolen Identity Event," Defendant replies that the EOS account must meet a definition of "Account" under the policy to be covered (id. at 3). Defendant continues to deny that Plaintiff pled damages because any loss would occur only if his account was covered (id. at 4).

4. Analysis

***7** For his First and Second Causes of Action (for declaratory relief and compensatory damages for breach of contract, respectively), Plaintiff needs to allege the existence of a contract with Defendant, that Defendant breached it, and (for the breach of contract claim) Plaintiff suffered damages from the breach.

The Complaint incorporated the Policy (Docket No. 1, Ex. A, Compl., Ex. A, Policy). Plaintiff has plausibly pled a breach of contract claim by inclusion of the Policy and alleging how Defendant breached it. The Policy's definition of "Account" (including the "Financial Institution" and "Stolen Identity Event" definitions for the use of the information to establish or use a deposit, credit, or other Account, Docket No. 1, Ex. A, Compl., Ex. A, Policy § VI., Definitions G., U., at 10) is limited to "U.S. regulated and domiciled" accounts (id., § VI., Definitions B., at 9).

The "Stolen Identity Event" is defined in Defendant's Policy as alternatives, either theft of personal information or use of the stolen information to access the member's "Account" (id., § VI., Definitions U., at 10).

a. Existence of Contract—Alleged Theft of Personal Information

The Policy defined a "Stolen Identity Event" as the theft of personal information (id.). Plaintiff states a claim for that theft and use of that personal information to commit a crime, here theft of the key credentials to Plaintiff's EOS cryptocurrency account and the looting of its contents (Docket No. 1, Ex. A, Compl. ¶¶ 8-9). These key credentials are another "method of identifying" Dr. Atwal (id., Ex. A, Policy § VI., Definitions U., at 10). Defendant has not argued that these credentials were not personal information or denied that they were used to commit a crime, the looting of Dr. Atwal's cryptocurrency account. Plaintiff thus has alleged the existence of a contract in Defendant offering to provide coverage for the loss of Dr. Atwal's personal information.

b. Existence of Contract—Access to "Account"

Examining the second alternative for Stolen Identity Event, Plaintiff has not alleged a breach from Defendant not covering the access to the EOS account because he has not claimed that account is from a domestic, regulated brokerage account to constitute an "Account" under the policy. Plaintiff has not alleged that a regulated, domestic brokerage firm held his EOS cryptocurrency account was or even identified the brokerage firm.

He has not alleged, for example, exchanges of his cryptocurrency as a security, cf. In re Bibox Group Holdings, supra, 534 F. Supp.3d 326, or a commodity, cf. CFTC v. McDonnell, supra, 287 F. Supp.3d at 228. While arguing that cryptocurrency may be purchased as a commodity subject to regulation, Dr. Atwal has not alleged that his EOS cryptocurrency was purchased as a commodity or regulated by the Commodity Futures Trading Commission (Docket No. 9, Pl. Memo. at 8, 9 & n.5, cf. CFTC v. McDonnell, 287 F. Supp.3d at 228). He has not alleged how he acquired the cryptocurrency. Had Plaintiff's acquisition of EOS cryptocurrency as a regulated security been alleged in the Complaint, the losses Dr. Atwal incurred from its theft would be covered under Defendant's Policy as from an "Account" from a U.S. regulated and domiciled brokerage.

Plaintiff also fails to allege entitlement to Fraudulent Withdrawal Coverage for suffering a Stolen Fund Loss under the Policy because Plaintiff's EOS loss had to be from a recognized, regulated "Account."

***8** Instead, he attempts to shift the burden to Defendant to prove that the EOS account was not a regulated, domiciled institution (cf. Docket No. 9, Pl. Memo. at 7-8). This burden shifting is incorrect; Plaintiff has the burden of alleging facts that state a claim to relief that are plausible on its face, Twombly, supra, 550 U.S. at 570, 127 S.Ct. 1955; it is not Defendant's burden to establish the opposite to support its Motion to Dismiss. Plaintiff needed to allege that the cryptocurrency account fell under the terms of Defendant's Policy.

The Complaint here does not allege the nature of the EOS cryptocurrency account except that it was a private account which contained over 2 million EOS funds before their theft (Docket No. 1, Ex. A, Compl. ¶¶ 7, 11). The Complaint also does not claim the accounts were regulated by a public institution. The indicia of domestic, public regulation that would make the account subject to the Policy are not alleged here. As alleged, these crypto assets are from private transactions that do not meet the Policy definition of an "Account" for coverage. Plaintiff has not alleged access to a member's "Account" and, therefore, has not alleged Defendant's Policy has been breached.

c. Defendant's Breach

Plaintiff, however, alleges breach of Defendant's Policy by Defendant not covering his loss of his personal information after the third-party stole his key credentials (Docket No. 1, Ex. A, Compl. ¶¶ 22-25). Defendant merely argues that Plaintiff's EOS cryptocurrency is not covered by the Policy and does not address the loss of Plaintiff's personal information.

d. Allegation of Damages

Finally, Plaintiff alleges damages from expending costs attempting to recover his cryptocurrency (id. ¶ 26), alleging at least $80,000 in damages (id. ¶ 36). "At the pleading stage, general factual allegations of injury resulting from the defendant's conduct may suffice, for on a motion to dismiss we 'presum[e] that general allegations embrace those specific facts that are necessary to support the claim.' [Lujan v.] National Wildlife Federation, supra, 497 U.S. [871, 110 S.Ct. 3177, 111 L.Ed.2d 695 (1990)], at 889, 110 S.Ct. at 3189," Lujan v. Defenders of Wilderness, 504 U.S. 555, 561, 112 S.Ct. 2130, 119 L.Ed.2d 351 (1992). Plaintiff has made sufficient allegation of damages to preclude dismissal.

Defendant's argument returns to its contention that Plaintiff's loss was not covered under the Policy, thus denying that Plaintiff incurred any damage (see Docket No. 6, Def. Memo. at 5; Docket No. 10, Def. Reply Memo. at 4). Given the finding above that Plaintiff alleged his loss for the theft of his key credentials and that he alleges damages therefrom, he has stated a claim for damages.

e. Conclusion

Plaintiff has alleged that Defendant's Policy covered the loss of his key credentials to his cryptocurrency as theft of Plaintiff's personal information. And thus, Defendant breached its Policy. Finally, he alleged damages from Defendant's failure to cover Plaintiff's claims. Defendant's Motion to Dismiss (Docket No. 6) the First and Second Causes of Action therefore is denied.

C. Third Cause of Action—Duty of Good Faith and Fair Dealing under New York Law

1. Applicable Standards

Generally, the implied covenant of good faith and fair dealing "embraces a pledge that 'neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the covenant,' " Dalton v. Educational Testing Serv., 87 N.Y.2d 384, 389, 639 N.Y.S.2d 977, 979, 663 N.E.2d 289 (1995) (quoting Kirke La Shelle Co. v. Armstrong Co., 263 N.Y. 79, 87, 188 N.E. 163, 167 (1933)).

***9** As observed in M/A-COM Sec. Corp. v. Galesi, 904 F.2d 134, 136 (2d Cir. 1990) (Docket No. 9, Pl. Memo. at 13), "where a party's acts subsequent to performance on the contract so directly destroy the value of the contract for another party that the acts may be presumed to be contrary to the intention of the parties, the implied covenant of good faith may be implicated. See Roli–Blue, Inc. v. 69/70th Street Assocs., 119 A.D.2d 173, 506 N.Y.S.2d 159 (1st Dep't 1986)."

A plaintiff alleges a claim for breach of implied covenant of good faith and fair dealing if he can " 'establish[ ] a legal duty separate and apart from contractual duties,' " Schonfeld v. Wells Fargo Bank, N.A., as Trustee for Aegis Asset Back Secs. Trust Mortgage Pass-Through Certs., No. 1:15-cv-01425, 2017 WL 4326057, at *5 (N.D.N.Y. Sept. 27, 2017) (quoting Washington v. Kellwood Co., No. 05 Civ. 10034, 2009 WL 855652, at *6 (S.D.N.Y. Mar. 24, 2009) (there dismissing breach of duty claim as subsumed in breach of contract claim)). A claim for good faith and fair dealing based upon the breach of the terms of the agreement

"is necessarily duplicative of a breach of contract claim," Washington, supra, 2009 WL 855652, at *6.

> "Generally, a claim for breach of an implied covenant of good faith and fair dealing does not provide a cause of action separate from a breach of contract claim. '[P]arties to an express contract are bound by an implied duty of good faith, but breach of that duty is merely a breach of the underlying contract.' Harris v. Provident Life & Accident Ins. Co., 310 F.3d 73, 80 (2d Cir. 2002),"

Dorset Indus., Inc. v. Unified Grocers, Inc., 893 F. Supp.2d 395, 405 (E.D.N.Y. 2012) (citations omitted).

"To establish a claim for breach of the implied covenant of good faith and fair dealing, a plaintiff must establish the following: '(1) defendant must owe plaintiff a duty to act in good faith and conduct fair dealing; (2) defendant must breach that duty; and (3) the breach of duty must proximately cause plaintiff's damages,' " Schonfeld, supra, 2017 WL 4326057, at *5 (quoting Washington, supra, 2009 WL 855652, at *6).

New York law, however, does not recognize a distinct tort for breach of the duty of good faith and fair dealing, New York Univ. v. Continental Ins. Co., 87 N.Y.2d 308, 639 N.Y.S.2d 283, 662 N.E.2d 763 (1995). Instead, breach of this duty is a source for consequential damages beyond the terms of an insurance policy, Certain Underwriters at Lloyd's v. BioEnergy Dev. Group LLC, 178 A.D.3d 463, 464, 115 N.Y.S.3d 240 240-41 (1st Dep't 2019). As consequential damages, these are "caused by a carrier's injurious conduct —in this case, the insurer's failure to timely investigate, adjust and pay the claim," Bi-Economy Market, Inc. v. Harleysville Insurance Co., 10 N.Y.3d 187, 196, 856 N.Y.S.2d 505, 510, 886 N.E.2d 127 (2008).

2. Parties' Contentions

Defendant asserts Plaintiff has not alleged any facts to support his breach of the implied covenant of good faith and fair dealing (Docket No. 6, Def. Memo. at 7). Plaintiff counters that Defendant breached the implied covenant of good faith and fair dealing by disregarding its obligations under its Policy and denying Plaintiff's claim (Docket No. 9, Pl. Memo. at 13).

3. Analysis

Implicit in the arrangement between these parties is a duty Defendant assumed of good faith and fair dealing in providing identity theft protection. This duty of good faith, however, cannot duplicate a breach of contract claim, Washington, supra, 2009 WL 855652, at *6.

***10** While Plaintiff may allege alternatively breach of contract and violation of the duty of good faith, see Fed. R. Civ. P. 8(d)(2), he needs to allege a duty distinct from performance of the Policy to allow for alternative pleading, see Dorset Indus., supra, 893 F. Supp.2d at 405. In Dorset Industries, plaintiff Dorset Industries contacted with Unified Grocers to provide marketing and merchandising services to Unified Grocers' member groceries with confidentiality and non-disclosure provisions in their contract, id. at 399, 400, 405. Plaintiff alleged (among other claims) breach of contract and breach of the covenant of good faith in misusing confidences and in appropriating proprietary information for Unified Grocers' own program, id. at 401-02. The Eastern District of New York held that so much of Dorset's breach of the duty of good faith duplicated its breach of contact claim for violations of the confidentiality and non-disclosure provisions, id. at 405. The court concluded, "thus, to the extent that the Plaintiff's claim for breach of the implied duty of good faith and fair dealing is premised on the Defendant's alleged use of the Plaintiff's confidential information to create a competing checkout program, that claim is dismissed," id. (citing Washington, supra, 2009 WL 855652, at *6 n.3). The court then held that Dorset had alleged a breach of this duty of good faith where Dorset alleged that its agreements with Unified Grocers implied that Unified Grocers would not create a competing program and plausibly alleged that Dorset had the reasonable expectation that Unified Grocers would use its efforts to enroll members in Dorset's program rather than for Unified Grocers' competing scheme, id. at 407-08.

See also The Dweck Law Firm, L.L.P. v. Mann, 340 F. Supp.2d 353, 358 (S.D.N.Y. 2004) (cf. Docket No. 9, Pl. Memo. at 12-13), where plaintiff law firm initially alleged a breach of contract claim for its retainer agreement with client

Cynthia Mann, but the court dismissed that claim because the firm failed to allege that it completed performance under the retainer, id. at 355-56, 358. The firm filed a new action alleging breach of the duty of good faith and fair dealing, stating "slightly different facts" that it rendered legal services to Mann, but Mann frustrated the firm's effort to complete its performance depriving compensation to the firm, id. at 356, 358, 359.

Contrast this with Dr. Atwal's allegations before this Court. Plaintiff has not alleged in his Third Cause of Action a distinct duty from Defendant's failure to perform under its identity theft protection Policy. He alleges that Defendant breached the duty of good faith and fair dealing by disregarding its obligations under the Policy (Docket No. 1, Ex. A, Compl. ¶¶ 39-40). This is identical to breach of that Policy.

Plaintiff does not allege an implied duty other than arising from the Policy. He sought coverage for his cryptocurrency and that coverage obligation arises entirely from the Policy. Unlike the cases cited by Plaintiff (cf. Docket No. 9, Pl. Memo. at 12-13), he has not alleged any implied promise interwoven with the Policy, cf. M/A-COM Sec. Corp., supra, 904 F.2d at 136, that Defendant breached by its nonperformance.

Dr. Atwal also has not alleged that NortonLifeLock hindered his performance. Instead, Plaintiff alleges his complete performance, and that Defendant breached its duty by not providing coverage when Plaintiff proffered his claim.

Plaintiff cites Bi-Economy Market, supra, 10 N.Y.3d at 194, 856 N.Y.S.2d at 509, 886 N.E.2d 127, arguing that Defendant breached the implicit obligation to pay Plaintiff's covered claim (id. at 13). Plaintiff's presented claims for consequential damages (the costs he incurred due to the EOS account being fraudulently accessed, see Docket No. 1, Ex. A, Compl. ¶¶ 26, 41), that he submitted this claim and its rejection (id. ¶¶ 22-24). Unlike Bi-Economy Market, see id. at 195, 856 N.Y.S.2d at 510, 886 N.E.2d 127, however, Plaintiff does not claim Defendant's subsequent acts destroyed the value of the Policy such that it was presumed to be contrary to the intention of the parties to the identity protection Policy.

The insurer in Bi-Economy Market delayed in payment of its replacement cost coverage and business interruption policy for the market's fire loss and paid less than the total loss incurred, id. at 191, 856 N.Y.S.2d at 507, 886 N.E.2d 127. The Court of Appeals held that damages there also included consequential damages for the insurer's delay in evaluating the claim and prompt payment, see id. at 195, 856 N.Y.S.2d at 510, 886 N.E.2d 127. The insurer's delay in adjusting that claim led to Bi-Economy Market losing its business, suffering additional, consequential damages from that delay, id. at 195, 856 N.Y.S.2d at 510, 886 N.E.2d 127.

***11** The dispute here, however, is whether Dr. Atwal's loss was covered under the Policy. Defendant argues that Plaintiff's EOS cryptocurrency account was outside of the Policy's coverage. There is no issue of the delay in Defendant's adjustment of this claim and the damages Plaintiff incurred. Plaintiff's alleged breach of duty of good faith and fair dealing remains identical to his breach of contract.

His Third Cause of Action for breach of the duty of good faith is duplicative of his Second Cause of Action for breach of contract. Thus, the Third Cause of Action fails to state a distinct claim and Defendant's Motion to Dismiss (Docket No. 6) this claim is granted.

D. Fourth Cause of Action—Unjust Enrichment

1. Applicable Standard

Plaintiff states a claim for unjust enrichment under New York law when he alleges that Defendant was enriched at Plaintiff's expense and equity and good conscience do not permit Defendant to retain what is sought to be recovered, Mandarin Trading Ltd. v. Wilderstein, 16 N.Y.3d 173, 182, 919 N.Y.S.2d 465, 471, 944 N.E.2d 1104 (2011) (citations omitted) (Docket No. 6, Def. Memo. at 8; Docket No. 9, Pl. Memo. at 14); Paramount Film Distrib. Corp. v. State of N.Y., 30 N.Y.2d 415, 421, 334 N.Y.S.2d 388, 393, 285 N.E.2d 695 (1972), cert. denied, 414 U.S. 829, 94 S.Ct. 57, 38 L.Ed.2d 64 (1973).

The theory of unjust enrichment under New York law is a quasi contract, recognizing "an obligation the law creates in the absence of any agreement," Goldman v. Metropolitan Life Ins. Co., 5 N.Y.3d 561, 587, 807 N.Y.S.2d 583, 587, 841 N.E.2d 742 (2005). An unjust enrichment claim is not

available to duplicate or replace a contract claim, Corsello v. Verizon N.Y., Inc., 18 N.Y.3d 777, 790, 944 N.Y.S.2d 732, 740, 967 N.E.2d 1177 (2012). Under New York law, the existence of a valid and enforceable written contract precludes recovery under an unjust enrichment theory, Clark-Fitzpatrick, Inc. v. Long Is. R.R., 70 N.Y.2d 382, 389, 521 N.Y.S.2d 653, 656-57, 516 N.E.2d 190 (1987); Sergeants Benevolent Ass'n Annuity Fund v. Renck, 19 A.D.3d 107, 112, 796 N.Y.S.2d 77, 81 (1st Dep't 2005) (Docket No. 6, Def. Memo. at 8); Goldman, supra, 5 N.Y.3d at 572, 807 N.Y.S.2d at 587, 841 N.E.2d 742; see Nieves v. Just Energy N.Y. Corp., No. 17CV561, 2020 WL 6803056, at *7 (W.D.N.Y. Nov. 19, 2020) (Skretny, J.).

A breach of contract and unjust enrichment claim also may be pled in the alternative in this Court, see Fed. R. Civ. P. 8(d)(2) (Docket No. 9, Pl. Memo. at 14-15); GlaxoSmithKline LLC v. Beede, No. 13CV1, 2014 WL 896724, at *7 (N.D.N.Y. Mar. 6, 2014), until a contract is found, see Kapsis v. American Home Mort. Servicing Inc., 923 F. Supp.2d 430, 454 (E.D.N.Y. 2013). Alternative pleading is permitted where the parties dispute the existence of a contract or that the contract applies to the subject matter of the lawsuit, see, e.g., ExamWorks, Inc. v. Soltys, No. 17CV80, 2017 WL 4712206, at *5 (W.D.N.Y. Aug. 10, 2017) (Vilardo, J.) (citing cases); Bristol Village, Inc. v. Louisiana-Pacific Corp., 916 F. Supp.2d 357, 367 (W.D.N.Y. 2013) (Skretny, C.J.).

Unjust enrichment, however, "is not a catchall cause of action to be used when others fail," Corsello, supra, 18 N.Y.3d at 790, 944 N.Y.S.2d at 740, 967 N.E.2d 1177. Under New York law, unjust enrichment is "available only in unusual situations when, though the defendant has not breached a contract or committed a recognized tort, circumstances create an equitable obligation running from the defendant to the plaintiff," id. at 790, 944 N.Y.S.2d at 740, 967 N.E.2d 1177; Spinnato v. Unity of Omaha Life Ins. Co., 322 F. Supp.3d 377, 404 (E.D.N.Y. 2018). For example, an unjust enrichment claim arises if "the defendant, though guilty of no wrongdoing, has received money to which he or she is not entitled," Corsello, supra, 18 N.Y.3d at 790, 944 N.Y.S.2d at 740, 967 N.E.2d 1177.

2. Parties' Contentions

***12** Defendant argues Plaintiff failed to allege facts in support of claim for unjust enrichment (Docket No. 6, Def. Memo. at 8). Defendant concludes Plaintiff cannot simultaneously recover for breach of contract and unjust enrichment (id.). Plaintiff replies that he alleged his breach of contract and unjust enrichment in the alternative and that he alleged unjust enrichment claim (Docket No. 9, Pl. Memo. at 14-15).

3. Analysis

Plaintiff under Federal Rules of Civil Procedure may plead claims in the alternative, Fed. R. Civ. P. 8(d)(2), provided (as previously observed) both claims are fully alleged and differ from each other, see Kapsis, supra, 923 F. Supp.2d at 454 (plaintiff sufficiently pled a plausible unjust enrichment claim with alternative contract clam, motion to dismiss unjust enrichment claim denied); Weisblum v. Prophase Labs, Inc., 88 F. Supp.3d 283, 296-97 (S.D.N.Y. 2015) (plaintiff failed to show his unjust enrichment claim differed from contract and tort claims, court dismissed the unjust enrichment claim). Even though he cannot recover for breach of contract and unjust enrichment under that contract, he can allege both claims in the alternative until a breach of contract claim is found, Kapsis, supra, 923 F. Supp.2d at 454.

The parties dispute whether the Policy applies to Plaintiff's stolen EOS cryptocurrency. At this pleading stage, Plaintiff alleged the existence of the contract, and it remains in dispute to allow alternative pleading of unjust enrichment.

The next issue is whether Plaintiff in fact has alleged an unjust enrichment claim under New York law. Plaintiff alleges that Defendant's enrichment was from Dr. Atwal paying premiums for coverage that Defendant later denied (Docket No. 1, Ex. A, Compl. ¶ 15). Equity and good conscience, however, permits Defendant to retain the premium while not covering Plaintiff's EOS losses. Plaintiff's lack of coverage resulting in unjust enrichment duplicates the breach of contract claim, Dama v. Prudential Ins. Co. of Am., No. 18-cv-3104, 2018 WL 670614, at *6 (E.D.N.Y. Dec. 20, 2018); see Spinnato, supra, 322 F. Supp.3d at 404 (unjust enrichment claim found

to duplicate other claims, dismissing the unjust enrichment claim).

This is not the "unusual" circumstance for an unjust enrichment claim, see Spinnato, supra, 322 F. Supp.3d at 404; Corsello, supra, 18 N.Y.3d at 790, 944 N.Y.S.2d at 740, 967 N.E.2d 1177. Every insurance coverage dispute would have alternative breach of contract and unjust enrichment claims for the insurer collecting premium but failing to provide coverage, see Katz v. American Mayflower Life Ins. Co. of N.Y., 14 A.D.3d 195, 198, 202, 788 N.Y.S.2d 15, 17, 19-20 (1st Dep't 2004) (plaintiff alleged existence valid, enforceable contract addressing coverage, unjust enrichment claim cannot survive). Since the matter of coverage is governed by the Policy, there is no unjust enrichment, Goldman, supra, 5 N.Y.3d at 587-88, 807 N.Y.S.2d at 587-88, 841 N.E.2d 742; see Clark-Fitzpatrick, supra, 70 N.Y.2d at 388, 521 N.Y.S.2d 653, 656, 516 N.E.2d 190 ("[t]he existence of a valid and enforceable written contract governing a particular subject matter ordinarily precludes recovery in quasi contract for events arising out of the same subject matter"). Absent alleged unusual circumstances, Plaintiff lacks a basis to allege the unjust enrichment claim (even in the alternative).

Defendant's Motion to Dismiss (Docket No. 6) the Fourth Cause of Action is granted.

IV. Conclusion

***13** Plaintiff states a breach of contract occurred when Defendant failed to cover the theft of Plaintiff's personal information (the key credentials for his cryptocurrency account). Thus, Defendant's Motion to Dismiss (Docket No. 6) the First and Second Causes of Action is denied (at least in part).

Since he alleged a breach of contract, Plaintiff cannot allege in the alternative quasi contract claims of breach of the duty of good faith or unjust enrichment. The Complaint fails to allege a distinct claim for breach of the duty of good faith apart from the Policy. Defendant's Motion (id.) to Dismiss the Third Cause of Action is granted.

As for the Fourth Cause of Action for unjust enrichment, while Plaintiff may alternatively allege that claim, he has not alleged unusual circumstances to state a distinct claim for unjust enrichment. Defendant's Motion to Dismiss (id.) that claim is granted.

With portions of First and Second Causes of Action surviving, Plaintiff is ordered to file an Amended Complaint stating these claims absent the allegations rejected in this Decision and Order. Plaintiff shall file and serve this Amended Complaint twenty-one (21) days from entry of this Order. Defendant then shall answer or move within fourteen (14) days of service of the Amended Complaint. After this pleading, this case will be referred to a Magistrate Judge for further pretrial proceedings.

V. Orders

IT HEREBY IS ORDERED, that Defendant NortonLifeLock, Inc.'s, Motion to Dismiss (Docket No. 6) is GRANTED IN PART and DENIED IN PART.

Plaintiff shall file an Amended Complaint stating the surviving claims (as identified in this Decision and Order) within twenty-one (21) days of entry of this Decision and Order. Defendant then shall answer or move to dismiss the amended pleading within fourteen (14) days of service of the amended pleading.

SO ORDERED.

All Citations

Slip Copy, 2022 WL 327471

Footnotes

1 In support of its Motion, Defendant submits its attorney's Declaration with exhibits (the Complaint and Notice of Removal) and Memorandum of Law, Docket No. 6. In opposition, Plaintiff submits his Memorandum of Law, Docket No. 9. Defendant replies with its Reply Memorandum, Docket No. 10.

2 "EOS" is an acronym for Electro-Optical System, based on blockchain technology, see https://www.investopedia/tech.what-is-eos; see also https://bitcoinist.com/what-is-eos-how-is-it-different-from-other-blockchains/; Williams v. Block.One, Nos. 20CV2809, 20CV3829, 2020 WL 4505569, at *1 (S.D.N.Y. Aug. 4, 2020) (EOS tokens are type of cryptocurrency); In re Bibox Group Holdings Ltd. Secs. Litig., 534 F. Supp. 3d 326, 327 (S.D.N.Y. 2021).

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TAB 37

Arberman v. PNC Bank, Nat'l Ass'n, Case No. 22-80983 (S.D. Fla.) 2022 WL 18402402

2022 WL 18402402
Only the Westlaw citation is currently available.
United States District Court, S.D. Florida,
West Palm Beach Division.

Rachelle ARBERMAN, Plaintiff,
v.
PNC BANK, NATIONAL ASSOCIATION, Defendant.

CASE NO. 22-80983-CIV-CANNON
|
Signed December 19, 2022

Attorneys and Law Firms

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ORDER GRANTING DEFENDANT'S MOTION TO DISMISS

AILEEN M. CANNON, UNITED STATES DISTRICT JUDGE

***1 THIS CAUSE** comes before the Court upon Defendant's Motion to Dismiss Plaintiff's Amended Complaint ("Motion") [ECF No. 18]. The Court has considered the Motion, Plaintiff's Response in Opposition [ECF No. 19], Defendant's Reply [ECF No. 20], and the full record. The Court also held a hearing on the Motion on November 30, 2022 [ECF No. 25]. For the reasons set forth below, Defendant's Motion to Dismiss Plaintiff's Amended Complaint [ECF No. 18] is **GRANTED**.

BACKGROUND [1]

Plaintiff's Amended Complaint alleges that Defendant PNC Bank, who serviced Plaintiff's checking account, negligently failed to protect Plaintiff from the exploitation of an unknown third-party fraudster, referred to in the Complaint as "Doe" or "John Doe" [ECF No. 15]. "At the time of the fraud, Plaintiff was 71 years old" and had begun "to suffer cognitive and physical decline consistent with that of an aging individual," resulting in slower and less confident decision-making abilities [ECF No. 15 ¶¶ 25–29].

In August 2020, Doe contacted Plaintiff falsely claiming to be a federal law enforcement officer [ECF No. 15 ¶ 9]. Over the course of approximately three months, Doe fraudulently coerced Plaintiff into withdrawing over $400,000 from her PNC Bank checking account and sending those funds in various forms to "one or more of John Doe's fraudulent enterprises" [ECF No. 15 ¶¶ 10–23, 45]. These transactions, "especially when aggregated, were wildly inconsistent with ... Plaintiff's normal monthly transactions" and "raised the suspicion of a bank employee" believed to a branch manager [ECF No. 15 ¶¶ 13–15]. That bank employee "approached Plaintiff to inquire about what was going on" but failed to take any additional steps to mitigate Plaintiff's losses [ECF No. 15 ¶¶ 14, 15, 38]. Plaintiff also alleges that "[t]he alleged safety measures in place at PNC Bank failed to detect the Plaintiff's large deposits and withdrawals from its branches" [ECF No. 15 ¶ 19].

The Amended Complaint brings one count of common law negligence, asserting that Defendant breached its duty to report Doe's exploitation of Plaintiff under Florida's Adult Protective Services Act ("FAPSA"), specifically Section 415.1034(1)(a)(8), by failing to take various actions: "failing ... to question" Plaintiff's high-value transactions during a short period of time; "[f]ailing to flag" the unusual activity in her account; and "[f]ailing to report the financial exploitation of Plaintiff," among other related actions [ECF No. 15 ¶ 43]. Plaintiff seeks an award of $428,490 in actual damages plus interest and attorneys' fees and costs [ECF No. 15 pp. 8–9].

Defendant moves to dismiss, arguing that Plaintiff has failed to plausibly allege two elements necessary to establish a duty under Section 415.1034(1)(a)(8): first, that Plaintiff is a "vulnerable adult" as defined in Section 415.102(28), and second, that Plaintiff was "exploited" within the meaning of 415.102(8)(a) [ECF No. 18 pp. 5–9]. Without a duty under FAPSA, Defendant continues, the Amended Complaint does not allege any other duty of care owed by Defendant to Plaintiff that could support a negligence theory [ECF No. 18 pp. 10–11].

LEGAL STANDARD

***2** Rule 8(a)(2) requires complaints to provide "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). To avoid dismissal under Rule 12(b)(6), a complaint must allege facts that, if accepted as true, "state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570, 127 S. Ct. 1955, 167 L. Ed. 2d 929 (2007); *see* Fed. R. Civ. P. 12(b)(6). A claim for relief is plausible if the complaint contains factual allegations that allow "the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S. Ct. 1937, 173 L. Ed. 2d 868 (2009). "The plausibility standard is not akin to a 'probability requirement,' but it asks for more than a sheer possibility that a defendant has acted unlawfully." *Id.* (quoting *Twombly*, 550 U.S. at 545). Conclusory allegations, unwarranted deductions of facts or legal conclusions masquerading as facts will not prevent dismissal. *Oxford Asset Mgmt., Ltd. v. Jaharis*, 297 F.3d 1182, 1188 (11th Cir. 2002).

DISCUSSION

A. *Florida Adult Protective Services Act*

Plaintiff argues that Defendant is liable for negligence because Defendant had a duty under FAPSA to "suspect that Plaintiff" was being "abused, neglected, or exploited" and then breached that duty by failing to take action to report Plaintiff's exploitation [ECF No. 15 ¶¶ 34–35, 43]. While Florida courts have held that FAPSA does not create a private cause of action against mandatory reporters, *see Mora v. S. Broward Hosp. Dist.*, 710 So. 2d 633, 634 (Fla. Dist. Ct. App. 1998), a plaintiff may pursue a common law negligence claim based on a statutorily created duty, even if that statute does not itself create a private cause of action, *see Kohl v. Kohl*, 149 So. 3d 127, 132 (Fla. Dist. Ct. App. 2014). Defendant therefore concedes that FAPSA can be the basis for a common law negligence claim against "mandatory reporters" as set forth in Fla. Stat. § 415.1034(1)(a)(8) [ECF No. 18 p. 5]. [2] Defendant argues, however, that the Amended Complaint fails to establish that Defendant owed a duty to Plaintiff under FAPSA, because the Amended Complaint does not sufficiently plead facts showing that (1) Plaintiff is a vulnerable adult; or (2) Plaintiff was exploited. For the reasons discussed below, the Court agrees with Defendant.

1. *"Vulnerable Adult"*

FAPSA defines a "vulnerable adult" to mean:

> a person 18 years of age or older whose ability to perform the normal activities of daily living or to provide for his or her own care or protection is impaired due to a mental, emotional, sensory, long-term physical, or developmental disability or dysfunction, or brain damage, or the infirmities of aging.

Fla. Stat. § 415.102(28).

Plaintiff argues that she satisfies this definition because she was 71 years old at the time of the fraud and was "experiencing the normal physical and cognitive decline as many 71-year olds," including slower and less confident decision-making [ECF No. 19 pp. 8–9 (relying on ECF No. 15 ¶¶ 26–29)]. Defendant responds that Plaintiff's allegations are conclusory and insufficient to fall within FAPSA's "vulnerable adult" definition as written and as applied in case law [ECF No. 18 pp. 5–7 (noting that Plaintiff controlled her finances, visited multiple bank branches to conduct transactions, purchased cryptocurrency from various vendors, read codes to Doe, sent checks and cash to FedEx pick up locations (referencing ECF No. 15 ¶¶ 18, 20–24))].

***3** A review of Plaintiff's allegations establishes that Plaintiff has not plausibly alleged that she was a "vulnerable adult" within the meaning of Section 415.102(28). The sum total of Plaintiff's allegations on this score are that: (1) "Prior to the fraud, Plaintiff began to suffer cognitive and physical decline consistent with that of an aging individual" [ECF No. 15 ¶ 26]; (2) "As a result of the Plaintiff's cognitive decline, Plaintiff is slower in making decisions than she was in the past" [ECF No. 15 ¶ 27]; (3) "As a result of Plaintiff's cognitive decline, Plaintiff is less confident in her decision-making abilities" [ECF No. 15 ¶ 28]; and (4) "When Plaintiff was younger, she was distrusting and it would have been very unlikely that she

would fall victim to this type of fraud" [ECF No. 15 ¶ 29]. As Defendant argues, these generalized allegations merely rephrase the "general infirmities of aging" language and do not provide any factual content to plausibly indicate that Plaintiff's ability to perform normal activities for her care or protection was "impaired" as required by Fla. Stat. § 415.102(28) (defining "vulnerable adult" as person "whose ability to perform the normal activities of daily living or to provide for his or her own care or protection is impaired due to a mental, emotional, sensory, long-term physical, or developmental disability or dysfunction, or brain damage, or the infirmities of aging"). Of course, this is not to say that FAPSA requires complete dependency to reach "vulnerable adult" status [*see* ECF No. 19 p. 9], but it does require impairment of a person's performance of daily activities. And here, for the reasons stated, the generalized allegations do not support such an impairment; Plaintiff traveled to multiple branches on various days to make multiple withdrawals; she purchased cryptocurrency via online vendors; she purchased gift cards; and she sent multiple cash withdrawals at various other vendors [ECF No. 15 ¶¶ 17–24]. Nor does the Amended Complaint contain any non-conclusory allegations implying that Plaintiff needed assistance for daily living or otherwise suffered from actual impairments. *See* Fla. Stat. § 415.102(28). The Court therefore agrees with Defendant that Plaintiff has not plausibly alleged "vulnerable adult" status under FAPSA. *See Woodruff v. TRG-Harbour House, Ltd.*, 967 So. 2d 248, 250 (Fla. Dist. Ct. App. 2007) (affirming dismissal of FAPSA claim for elder abuse, where appellant entered into various property-related agreements, and complaint otherwise failed to set forth facts sufficient to show "vulnerable adult" status); *Shave v. Stanford Coins & Bullions, Inc.*, No. 08-CV-61503, 2009 WL 1748084, at *4 (S.D. Fla. June 19, 2009) (dismissing elder abuse claim under FAPSA, where plaintiff alleged only generally that he was of advanced age with limited knowledge and sophistication).

2. *"Exploitation"*

Defendant also argues that even if Plaintiff satisfies the definition of "vulnerable adult" under FAPSA, dismissal remains warranted as an alternative and independent matter, because Plaintiff has not plausibly alleged that she was "exploited" within FAPSA's statutory definition of "exploitation." Fla. Stat. § 415.102(8)(a). The Court agrees.

The relevant section in FAPSA on "exploitation" is quoted below:

> Exploitation means a person who:
>
> 1. Stands in a position of trust and confidence with a vulnerable adult and knowingly, by deception or intimidation, obtains or uses, or endeavors to obtain or use, a vulnerable adult's funds, assets, or property with the intent to temporarily or permanently deprive a vulnerable adult of the use, benefit, or possession of the funds, assets, or property for the benefit of someone other than the vulnerable adult; or
>
> 2. Knows or should know that the vulnerable adult lacks the capacity to consent, and obtains or uses, or endeavors to obtain or use, the vulnerable adult's funds, assets, or property with the intent to temporarily or permanently deprive the vulnerable adult of the use, benefit, or possession of the funds, assets, or property for the benefit of someone other than the vulnerable adult.

Fla. Stat. § 415.102(8)(a).[3]

FAPSA then proceeds in the next subsection, Section 415.1028(b), to provide examples of "[e]xploitation" to include, but "not limited to":

> 1. Breaches of fiduciary relationships, such as the misuse of a power of attorney or the abuse of guardianship duties, resulting in the unauthorized appropriation, sale, or transfer of property;
>
> 2. Unauthorized taking of personal assets;
>
> 3. Misappropriation, misuse, or transfer of moneys belonging to a vulnerable adult from a personal or joint account; or
>
> 4. Intentional or negligent failure to effectively use a vulnerable adult's income and assets for the necessities required for that person's support and maintenance.

Id. § 415.102(8)(b).

Defendant asserts that Plaintiff fails to plausibly allege (1) that Doe (pretending to be a law enforcement officer) stood "in a position of trust and confidence" with Plaintiff; or (2) that Doe knew or should have known that Plaintiff lacked "the capacity to consent" [ECF No. 18 p. 19]. In Plaintiff's written opposition, Plaintiff fails to address the requirements

of Section 405.102(8)(a), asserting instead that the non-exhaustive list of examples of "exploitation" in Section 405.102(8)(b) establishes that she was exploited [ECF No. 19 pp. 9–10 (stating that she suffered an "unauthorized taking of personal assets" and had her money misappropriated, misused, and transferred)]. At the hearing, Plaintiff for the first time attempted to satisfy the requirements of Section 415.102(8)(a) by asserting that (1) "John Doe" "stood in a position of trust and confidence" with Plaintiff because she believed he was a law enforcement officer; and (2) "John Doe" should have known she "lack[ed] the capacity to consent" because she fell victim to the scheme.

***4** Plaintiff's arguments as to FAPSA-defined "exploitation" lack merit. As the structure of the pertinent definitional sections indicate, FAPSA first sets forth the requirements of who commits exploitation under the statute, Fla. Stat. § 415.102(8)(a), and then it provides a non-exhaustive list of acts that would constitute exploitation by those specified persons. Plaintiff has not plausibly alleged any basis to satisfy Section 415.102(8)(a). For one, even assuming that Plaintiff qualifies as a "vulnerable adult" under Fla. Stat. § 415.1028(a), Doe does not fall into any of the specified categories sufficient to occupy a "position of trust and confidence" as defined in the statute. *Supra* n.3. Nor does the Amended Complaint allege that Doe knew Plaintiff "lack[ed] the capacity to consent" merely because she fell victim to Doe's fraudulent scheme. "[C]apacity to consent" is defined in FAPSA to "mean[ ] that a vulnerable adult has sufficient understanding to make and communicate responsible decisions regarding the vulnerable adult's person or property, including whether or not to accept protective services offered by the department." Fla. Stat. § 415.102(4). Here, while transferring $400,000 to a person believed to be a law enforcement officer arguably could establish that Plaintiff makes irresponsible financial decisions (again assuming "vulnerable adult" status), Plaintiff does not allege that Doe knew or had reason to know of any alleged "lack of capacity." And, as stated above, Plaintiff admits that she had complete access over her accounts and managed them through various in-person and cryptocurrency transactions executed by her personally [ECF No. 15 ¶¶ 17–24]. In sum, Plaintiff falling victim to Doe's scheme, standing alone, does not plausibly establish that Doe should have known of any purported lack of capacity on the part of Plaintiff, and Plaintiff offers no support for that legal theory.

***

Because Plaintiff has failed to plead facts to plausibly allege that she is a "vulnerable adult" or that she suffered "exploitation" as defined in FAPSA, she has failed to establish that Defendant owed a statutory duty to her under FAPSA. For either or both of those reasons, Plaintiff's negligence cause of action as rooted in a FAPSA duty cannot proceed. Nor does Plaintiff identify any other duty on the part of Defendant that could support her negligence cause of action. Plaintiff generally refers to a "baseline duty of care" in the Amended Complaint [ECF No. 15 ¶¶ 36–38; *see* ECF No. 19 p. 6], but banking institutions do not have a duty under Florida law to investigate transactions made by authorized users and account holders. *See* *Lawrence v. Bank of Am., N.A.*, 455 F. App'x 904, 907 (11th Cir. 2012); *cf.* *O'Halloran v. First Union Nat. Bank of Fla.*, 350 F.3d 1197, 1205 (11th Cir. 2003) (suggesting that banks may owe a duty to an account holder when *a non-account holder* makes transactions purportedly on behalf of the account holder). Here, although the Amended Complaint references several unusual transactions, every transaction at issue was conducted by Plaintiff herself, the authorized account holder [ECF No. 15 ¶¶ 16–24]. *See* *Biondi v. Branch Banking & Tr. Co.*, No. 18-CV-22521, 2018 WL 6566027, at *3–4 (S.D. Fla. Aug. 28, 2018) (collecting cases).

CONCLUSION

For the foregoing reasons, it is hereby

ORDERED and ADJUDGED as follows:

1. PNC Bank's Motion to Dismiss [ECF No. 18] is **GRANTED**.

2. Plaintiff's Amended Complaint is **DISMISSED WITH PREJUDICE**. [4]

DONE and ORDERED in Chambers in Fort Pierce, Florida, this 19th day of December 2022.

All Citations

Slip Copy, 2022 WL 18402402

Footnotes

1 The facts in this section are drawn from Plaintiff's Amended Complaint [ECF No. 15] and accepted as true for the purposes of this Order.

2 It is not entirely clear to the Court that Defendant PNC Bank—as distinct from PNC's "officer, trustee, or employee"—is properly deemed a mandatory reporter under the relevant FAPSA definition. *See* Fla. Stat. § 415.1034(1)(a)(8) (applying to "[a]ny person, including, but not limited to, any "[b]ank, savings and loan, or credit union *officer, trustee, or employee*," and then listing various additional categories of *individual* mandatory reporters such as physicians, municipal employees, and investment advisers (emphasis added)). Although Plaintiff references an unnamed bank employee in the Complaint, Plaintiff sues PNC Bank only in this case.

3 The statute further defines "[p]osition of trust and confidence" as "a person who"

> (a) Is a parent, spouse, adult child, or other relative by blood or marriage;
>
> (b) Is a joint tenant or tenant in common;
>
> (c) Has a legal or fiduciary relationship, including, but not limited to, a court-appointed or voluntary guardian, trustee, attorney, or conservator; or
>
> (d) Is a caregiver or any other person who has been entrusted with or has assumed responsibility for the use or management of the vulnerable adult's funds, assets, or property

Id. § 415.102(19).

4 Giving Plaintiff leave to amend would be futile. Plaintiff amended her complaint once before following an earlier motion to dismiss raising the same arguments [ECF Nos. 10, 15], and the only allegation she claimed at the hearing she would add if given an opportunity to amend is an additional allegation specifying that a federal law enforcement officer stands in a "position of trust" with Plaintiff under FAPSA. The Amended Complaint already alleges that Plaintiff believed Doe was a law enforcement officer [ECF No. 15 ¶ 9]; the Court accepts that allegation as true; and in any event, merely alleging that a law enforcement officer stands in a "position of trust and confidence" cannot supplant the statutory definition of that term in FAPSA, which does not include law enforcement officers standing alone. *See* Fla. Stat. § 415.102(19) (quoted in footnote 3).

TAB 38

Diamond Fortress Techs., Inc. v. EverID, Inc., C.A. No. N21C-05-048 PRW (Del. Super. Ct. 2022)

274 A.3d 287
Superior Court of Delaware.

DIAMOND FORTRESS TECHNOLOGIES, INC., and Charles Hatcher, II, Plaintiffs,
v.
EVERID, INC., Defendant.

C.A. No. N21C-05-048 PRW CCLD
|
Submitted: January 18, 2022
|
Decided: April 14, 2022

Synopsis

Background: Licensor of biometric software and its chief executive officer (CEO) filed breach of contract action against licensee, alleging that licensee breached software license agreement, and related advisor agreement with CEO, by failing to remunerate licensor and CEO via cryptocurrency token distributions, as required in the agreement. After obtaining partial grant of its motion for default judgment on the issue of breach, licensor and its CEO sought assessment of damages.

Holdings: In a case of apparent first impression, the Superior Court, Paul R. Wallace, J., held that:

[1] cryptocurrency-paid agreements were investment contracts for Securities Act purposes;

[2] historical pricing data from publicly-available website that published data on digital assets was reliable valuation tool to determine value of cryptocurrency tokens;

[3] appropriate valuation method for tokens was calculation of higher value of either tokens' value at time of breach or tokens' highest intermediate value between notice of breach and reasonable time for replacement.

Motion granted.

Procedural Posture(s): Motion for Default Judgment/Order of Default.

West Headnotes (25)

[1] **Contracts** Renunciation

A repudiation coupled with simultaneous nonperformance gives rise to an action for total breach, allowing the non-breaching party to bring an action for the entire contract price.

[2] **Securities Regulation** In general; investment contracts

Whether a transaction or instrument qualifies as an investment contract subject to the Securities Act is a highly fact-specific inquiry, in which courts must examine the series of understandings, transactions and undertakings at the time they were made, and accordingly, an application of such test requires an examination of the entirety of the parties' understandings and expectations. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[3] **Securities Regulation** In general; investment contracts

An investment of money need not be made in cash in order to be determined a part of the relevant transaction, as factor supporting determination that a transaction or instrument qualifies as an investment contract for Securities Act purposes, and refers more generally to an arrangement whereby an investor commits assets to an enterprise or venture in such a manner as to subject himself to financial losses. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[4] **Securities Regulation** In general; investment contracts

When determining whether a transaction or instrument qualifies as an investment contract for Securities Act purposes, courts look to see if a common enterprise exists where the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking

the investment of third parties. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[5] **Securities Regulation** In general; investment contracts

"Horizontal commonality," as grounds for finding common-enterprise factor supporting determination that a transaction or instrument qualifies as an investment contract for Securities Act purposes, requires one to show a pooling of the investors' interests or assets, such that all involved share in the profits and risks of the enterprise alike. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[6] **Securities Regulation** In general; investment contracts

"Vertical commonality," as grounds for finding common-enterprise factor supporting determination that a transaction or instrument qualifies as an investment contract for Securities Act purposes, requires that the fortunes of investors be tied to the fortunes of the promoter. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[7] **Securities Regulation** Particular interests

Where one initially pools his investors' money in order to develop and launch a digital token and blockchain platform, he effectively renders his investors' profits entirely dependent upon the blockchain's successful launch, for purposes of a finding of horizontal commonality under common-interest factor of test for determining whether a transaction or instrument qualifies as an investment contract for Securities Act purposes; if the launch is unsuccessful, the investors are equally affected and lose any opportunity to profit. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[8] **Securities Regulation** Particular interests

In transactions involving the launch of a digital token and blockchain platform, horizontal commonality, as grounds for finding common-enterprise factor of test for determining whether a transaction or instrument qualifies as an investment contract for Securities Act purposes, can exist post-launch because the value of each token to be distributed thereafter is dictated by the success or failure of the blockchain enterprise as a whole; the plain economic reality post-launch is that the distribution of the tokens continues to represent the investors' initial pooled funds. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[9] **Securities Regulation** In general; investment contracts

An investor possesses an expectation of profit, for purposes of test to determine whether a transaction or instrument qualifies as an investment contract for Securities Act purposes, when their motivation to partake in the relevant contract, transaction or scheme was the prospects of a return on their investment. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[10] **Securities Regulation** In general; investment contracts

When determining whether an investor possesses an expectation of profit solely from the efforts of a promoter or a third party, as factor supporting determination that a transaction or instrument qualifies as an investment contract for Securities Act purposes, a court considers whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[11] **Securities Regulation** In general; investment contracts

Factor supporting a determination that a transaction or instrument qualifies as an investment contract for Securities Act purposes based on an investor's expectation of profits solely from the efforts of a promoter or a third

party is satisfied where investors' fortunes are directly tied to the failure or success of the products the investee purports to develop, and no individual investor can exert control over the success or failure of his or her investment. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[12] **Securities Regulation** Particular interests

In transactions involving the launch of a digital token and blockchain platform, an investor's expectation of profits relies on the essential efforts of investee, as factor supporting a determination that a transaction or instrument qualifies as an investment contract for Securities Act purposes, when he or she wholly depends on that investee to develop, launch, and support the blockchain. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[13] **Securities Regulation** Particular interests

Investment of money was part of transaction between licensee of biometric software and licensor and licensor's chief executive officer (CEO), as factor supporting determination that cryptocurrency-paid biometric software license agreement and related advisor agreement were investment contracts for Securities Act purposes; licensor and its CEO committed both exclusive license to biometric software and related professional services to licensee's then-developing, blockchain-based cryptocurrency platform, licensor and its CEO elected to be paid in eventual token distributions rather than by traditional means, and licensor and its CEO bore risk of fluctuations in cryptocurrency value, subjecting themselves to any attendant financial losses. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[14] **Securities Regulation** Particular interests

Licensee of biometric software's efforts, using licensor and its chief executive officer's (CEO) investments, to develop successful cryptocurrency token created common enterprise, as factor supporting determination that cryptocurrency-paid biometric software license agreement and related advisor agreement were investment contracts for Securities Act purposes; licensee relied on licensor and its CEO's software license and professional services to successfully develop and launch its blockchain platform, in turn, licensor and its CEO's ability to recover any remuneration for their investment was interwoven with and wholly dependent on successful launch of licensee's blockchain, and any future distribution, or continued growth of token's value, was representative of licensee and its CEO's investment in blockchain platform. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[15] **Securities Regulation** Particular interests

Licensor of biometric software and its CEO had an expectation of profit solely from the efforts licensee, who was launching cryptocurrency and blockchain platform, as factor supporting determination that cryptocurrency-paid biometric software license agreement and related advisor agreement were investment contracts for Securities Act purposes; licensor and its CEO acquiesced to licensee's demand for exclusive license on condition that licensee allocate and distribute significant amount of tokens at initial coin offering (ICO), token grant was in lieu of traditional compensation for licensor and its CEO's contributions to licensee, and licensor and CEO's expected profits were directly tied to failure or success of licensee's blockchain platform. Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

[16] **Contracts** Questions for Jury

A contract's proper construction is a question of law.

[17] **Contracts** Intention of Parties

The goal of contract interpretation is to fulfill the parties' shared expectations at the time they contracted.

[18] **Damages** Under circumstances within contemplation of parties

The standard remedy for breach of contract is based on the reasonable expectations of the parties that existed before or at the time of the breach.

[19] **Damages** Mode of estimating damages in general

Breach of contract damages are designed to place the injured party in the same place as he would have been if the contract had been performed, and such damages should not act as a windfall.

[20] **Damages** Under circumstances within contemplation of parties

When assessing damages for breach of contract, the non-breaching party is entitled to recover damages that arise naturally from the breach or that were reasonably foreseeable at the time the contract was made.

[21] **Damages** Failure to pay money

Historical pricing data from publicly-available website that published data on digital assets was reliable valuation tool to determine value of cryptocurrency tokens owed by licensee of biometric software to licensor and licensor's chief executive officer (CEO) pursuant to biometric software license agreement and related advisor agreement; website was frequently used by news publications to report on prices of virtual currencies, and website was favorably referenced in proposed federal legislation providing for regulation of digital assets and digital asset securities.

[22] **Conversion and Civil Theft** Property of fluctuating value

The measure of damages for wrongful conversion of stock or properties of like character is the higher value of either: (1) its value at the time of conversion or (2) its highest intermediate value between notice of the conversion and a reasonable time thereafter during which the stock could have been replaced.

[23] **Conversion and Civil Theft** Questions for jury

What constitutes a reasonable period of time to replace an asset on the open market, for purposes of calculating damages for wrongful conversion of stock or properties of like character, is a question of law for the court to determine.

[24] **Damages** Failure to pay money

Appropriate valuation method, in action by biometric software licensor and its chief executive officer (CEO) against licensee, who launched cryptocurrency and blockchain platform, for breach of biometric software license agreement and related advisor agreement based on licensee's failure remunerate licensor and its CEO by distributing cryptocurrency tokens in lieu of traditional payment, was calculation of the higher value of either tokens' value at time that licensee breached the agreements or tokens' highest intermediate value between notice of breach and reasonable time thereafter during which tokens could have been replaced.

[25] **Damages** Failure to pay money

Three-month reasonable time period for licensor of biometric software and its chief executive officer (CEO) to replace cryptocurrency tokens owed to them under biometric software license agreement and related advisor agreement on open market began to run, for purposes of calculation of damages due to licensor and its CEO in their action against licensee for breach of

contract, on date that licensee and its CEO sent their final communication to licensee declaring their intent to treat agreements as breached and to pursue legal remedies.

***291** *Upon Plaintiffs Diamond Fortress Technologies, Inc., and Charles Hatcher, II's Motion for Default Judgment,* **GRANTED.**

Attorneys and Law Firms

Kurt M. Heyman, Esquire, Heyman Enerio Gattuso & Hirzel, Wilmington, Delaware; Walter A. Dodgen, Esquire, Zachary P. Mardis, Esquire, Maynard, Cooper & Gale, PC, Huntsville, Alabama. Attorneys for Plaintiffs Diamond Fortress Technologies, Inc., and Charles Hatcher, II.

United States Corporation Agents, Inc., Middletown, Delaware. Registered Agent for Defendant EverID, Inc.

OPINION

WALLACE, J.

This breach-of-contract action arises out of Defendant EverID, Inc.'s failure to compensate the Plaintiffs, Diamond Fortress Technologies, Inc. and its CEO Charles ***292** Hatcher, II, for their combined assistance in developing EverID's cryptocurrency trading platform and mobile application.

For an exclusive license to use Diamond Fortress's proprietary biometric software, EverID offered to remunerate the Plaintiffs via cryptocurrency token distributions. The promised distributions were to occur upon the Initial Coin Offering ("ICO") of "ID Tokens," EverID's newly created cryptocurrency, and upon subsequent Token Distribution Events ("TDEs"). The ICO and several TDEs came and went without Plaintiffs receiving a single token. No surprise, they then sued EverID.

EverID has never responded, appeared, or otherwise defended itself in any manner in this lawsuit. So the Plaintiffs filed a default judgment motion that the Court granted in part —the Court found the breach but paused on the damages. The Court conducted a subsequent hearing on the Plaintiffs' purported economic damages that centered on just what might be the appropriate methodology and value source for reckoning a damages judgment. The classification and valuation of cryptocurrency, as well as the calculation of damages resulting from the breach of a cryptocurrency-paid contract are novel matters to Delaware.

I. FACTUAL AND PROCEDURAL BACKGROUND [1]

A. THE PARTIES

Diamond Fortress is a biometric software company. [2] Mr. Hatcher is Diamond Fortress's CEO—one with extensive experience in the global market of biometric authentication and identity platform architecture. [3]

Diamond Fortress developed a patented software named "ONYX." [4] ONYX is a secure, touchless fingerprint-identification software application that utilizes the camera on mobile devices, *e.g.*, smartphones, to detect and verify user identities by fingerprint recognition. [5] Third parties can integrate the ONYX software into their own platforms by purchasing a license and software development kit. [6] Mr. Hatcher is often hired as an advisor by those buyers to assist with the ONYX software integration and the management of its use thereafter. [7]

EverID, an entity active in the blockchain and cryptocurrency industry, is a corporation organized under Delaware law that maintains its principal office in Poway, California. [8] It created the cryptocurrency ***293** "ID Tokens." [9] As a component of ID Tokens, EverID also developed a blockchain-based identity and financial platform but needed the means to verify and confirm its users' identities. [10]

B. THE LICENSE AND ADVISOR AGREEMENTS

In or around September of 2017, the parties conferred about integrating the ONYX software into EverID's then-developing cryptocurrency enterprise. [11]

In addition to integrating the ONYX software into its platform, EverID made other demands. First, it requested Mr. Hatcher serve as an advisor and mentor for the integration and duration of its use of ONYX. [12] Second, it required Diamond Fortress to grant EverID an exclusive license to ONYX for digital or blockchain wallets; that required Diamond Fortress

to halt its then-active endeavors soliciting other opportunities in the blockchain industry.[13] For the award of EverID's exclusive ONYX software license, Diamond Fortress and Mr. Hatcher agreed to be compensated in EverID's ID Tokens when EverID eventually held its ICO (the cryptocurrency equivalent of an initial public offering[14]) and subsequent TDEs.[15] The periodic token distributions were to be the means of satisfying EverID's payment obligation in lieu of Diamond Fortress's standard payment requirement of quarterly license "Run-Time Transaction Fees."[16]

Diamond Fortress and Mr. Hatcher agreed to EverID's demands, and the respective License and Advisor Agreements (together "Agreements") negotiations commenced.[17] While the Agreement negotiations were underway, Plaintiffs granted EverID a software license key to immediately begin its integration and use of ONYX.[18] Mr. Hatcher also began assisting EverID with its mobile application development utilizing the ONYX software.[19]

1. *ONYX Software Development Kit License Agreement.*

In September of 2018, Diamond Fortress and EverID finalized the License Agreement for EverID's use of the ONYX software.[20] The Agreement is valid for a ten-year term and is governed by Delaware law.[21]

The terms and means of compensation are expressly set forth in the Agreement. Upon execution of the Agreement, an initial license fee of $2,500 U.S. Dollars ("USD") was to be remitted by EverID.[22] EverID was also obligated to tender "Run-Time Transaction Fees," which equated to fifteen percent (15%) of the gross revenues ***294** received from its use of ONYX, to be paid quarterly.[23] As discussed above, these fees were negotiated away in exchange for a set amount of ID Tokens and subsequent periodic token distributions.

Thus, Diamond Fortress's real economic interest for entering into this transaction—and its concession to give EverID an exclusive license to use ONYX—is EverID's assurance "to engage in a token sale" and award Diamond Fortress for its services accordingly:

> Ten Million (10,000,000) of ID tokens at the ICO or TDE to [Diamond Fortress]. This token grant shall be deemed to be an advance of, and credited to, [EverID] as payment for the Run-Time Transaction Fees. The value of this token grant shall be determined by multiplying the number of tokens granted times the ICO or last TDE price.[24]

Additionally, the token grants are subject to a distribution lock-up, awarding the initial 25% of the tokens at the ICO or final TDE and the remaining 75% to be "distributed in **20** equal **quarterly** distributions" after the ICO or final TDE.[25]

2. *Charles Hatcher's Advisor Agreement.*

EverID executed a separate Advisor Agreement with Mr. Hatcher.[26] Under this Agreement, Mr. Hatcher's role was that of an independent contractor to mentor or advise EverID on an as-needed basis.[27]

Mr. Hatcher's compensation structure mostly mirrors Diamond Fortress's, with just a variation in the number of tokens allocated and the distribution schedule. EverID was to distribute Two Million Five Hundred Thousand (2,500,000) tokens to Mr. Hatcher at the ICO or final TDE.[28] Similar to Diamond Fortress's lock-up distribution, the initial 25% of the tokens were to be distributed at the ICO or final TDE, with the remaining 75% of tokens to be "distributed in **24** equal **monthly** distributions after the ICO or final TDE."[29]

As some clue as to how the parties intended the ID Tokens be treated or classified, both Agreements expressly provide that the token distributions "will also be subject to regulatory compliance such a [sic] Rule 144 of the Securities Act of 1933 ...."[30]

C. EVERID'S BREACH AND THE INSTANT LITIGATION

EverID's ICO occurred on February 8, 2021, and EverID should have then tendered its first partial payments to the Plaintiffs.[31] EverID didn't.[32] Despite numerous efforts to obtain EverID's assurances that the token distributions were forthcoming—both directly and via counsel—EverID ***295** refused to respond or distribute the tokens.[33]

Diamond Fortress and Mr. Hatcher initiated suit here alleging two counts of Breach of Contract—one count for each Plaintiff.[34] Upon EverID's failure to respond or otherwise defend itself, the Plaintiffs filed a motion for default judgment.[35]

Consistent with this Court's Civil Rule 55(b), which provides for entry of default judgment "when a party against whom a judgment for affirmative relief is sought, has failed to appear, plead or otherwise defend as provided by these Rules,"[36] the Court granted the Plaintiffs' motion with respect to EverID's liability for its breaches. EverID's failure to provide any assurance within a reasonable time, as well as its non-performance of payment, constituted a repudiation and total breach of both Agreements.[37] But what then is the remedy?

As observed recently, "Delaware law largely remains silent" on scenarios such as this.[38] That said, "significant authority supports the conclusion that a repudiation coupled with simultaneous non-performance gives rise to an action for total breach."[39]

For instance, *Corbin on Contracts* teaches:

> Suppose next that the contract requires performance in installments or continuously for some period and that there has been such a partial failure of performance as justifies immediate action for a partial breach. If this partial breach is accompanied by repudiation of the contractual obligation such repudiation is anticipatory with respect to the performances that are not yet due. In most cases, the repudiator is now regarded as having committed a "total" breach, justifying immediate action for the remedies appropriate thereto .... The non-performance plus the repudiation constitute one and only one cause of action.[40]

[1] And though Delaware has not *per se* adopted the Restatement (Second) of Contracts rule regarding repudiation and adequate assurances, our courts have historically relied on its guidance in such situations.[41] The rule prescribes that upon an obligee's request for adequate assurance of performance by the obligor, "the obligee may treat as a repudiation the obligor's failure to provide" such assurance within a reasonable time.[42] And "a repudiation coupled with simultaneous nonperformance ***296** gives rise to an action for *total breach*, allowing the non-breaching party to bring an action for the *entire contract price*."[43]

Accordingly, the Court determined EverID had indeed repudiated and was in total breach of both Agreements.[44] Given the novel circumstances of this case, however, a decision on damages was reserved pending further record development. Under this Court's Civil Rule 55(b), "[j]udgment is to be entered by the Court when the plaintiff's claim is for a sum which is uncertain or cannot be fixed with certainty by computation."[45] And when such uncertainty is present, and the Court must "determine the amount of damages[,]" Rule 55(b)(2) authorizes the Court to "conduct such hearings ... as it deems necessary and proper ...."[46]

The Plaintiffs supplemented the record with additional briefing supporting their damages claim.[47] The Court heard Diamond Fortress and Mr. Hatcher on the supplemented record. This is the Court's judgment and explication on the computation of damages arising out of EverID's failure to distribute the ID tokens as required under the License and Advisor Agreements.

II. LEGAL ANALYSIS

A. CRYPTOCURRENCY, BLOCKCHAIN TECHNOLOGY, AND BITCOIN

It seems no Delaware court has yet grappled with the question posed here: When the consideration to be paid on a contract is in cryptocurrency and the contract is breached, how does the Court calculate the judgment to be entered?

A brief history of cryptocurrency, Bitcoin, and blockchain technology might help one understand the Court's answer here.

Cryptocurrency is a type of digital or virtual currency "maintained by a decentralized network of participants' computers."[48] Cryptocurrencies are unique as they "exist solely on the internet and are unregulated and unmanaged by third parties, such as banks or governments."[49] It uses cryptography for security, and "[l]ike traditional forms of currency, cryptocurrency can be bought and sold on digital ***297** exchanges."[50] Like an initial public offering in a securities context, an initial coin offering, or ICO, occurs when a new species of cryptocurrency token is issued in exchange for fiat or already circulating virtual currencies to raise capital.[51]

Cryptocurrency relies on blockchain technology, a distributed ledger system, to ensure the security and integrity of the virtual currency.[52] Blockchain technology is a peer-to-peer system that tracks and records digital transactions around the globe.[53]

> To use a blockchain system, a user first creates a wallet, which contains information used to move units of a cryptocurrency on a blockchain. When the user downloads or purchases a wallet, software in the wallet generates a private key (a large integer number). That private key is then used to mathematically generate a public key (also a large integer number), which is used to create an address (a mix of numbers and symbols). This address functions as the name suggests: it is the destination for a cryptocurrency payment.[54]

To avoid risks of double-spending, blockchain places a series of transactions into a block, issues a timestamp, then chronologically incorporates the blocks into a larger chain of all the blocks within the ledger.[55] "Each block is irreversibly connected by a 'proof-of-work' protocol, the process by which a computer must solve a complex puzzle to authenticate each transaction and add it to the growing blockchain."[56] This authentication process is known as "mining," or rather, the production of new coins or tokens.[57]

Bitcoin is a well-known name in the cryptocurrency world and is a type of digital currency that uses the blockchain technology.[58] "Generally speaking, 'Bitcoin' in the capitalized singular refers to the cryptocurrency with the symbol BTC, while 'bitcoin' or 'bitcoins' refers more generally to cryptocurrency, inclusive of the cryptocurrency modeled on Bitcoin."[59]

Bitcoin uses the "Bitcoin Blockchain" to track ownership and transfers "of every bitcoin in existence."[60] To transfer bitcoins, a user must have a wallet, which, again, is a unique digital file that stores the bitcoin information.[61] Bitcoins can be acquired either by the mining process or simply by receiving them from someone else.[62] The ***298** premise of Bitcoin was to use the blockchain technology for a "peer-to-peer version of electronic cash" that prevents fraudulent spending but without the oversight of regulatory policing.[63]

B. SECURITY VS. COMMODITY

Incidentally, the lack of regulatory policing of cryptocurrency is not without its problems and is on full display in the instant litigation. Before the Court can fashion a proper damages award, it must first determine how to classify cryptocurrency, *i.e.*, is it a security/investment contract, a commodity, property, or currency?

Lending to this problem is a lack of consensus among certain authorities on how to treat cryptocurrency. For instance, the Commodity Futures Trading Commission (CFTC) insists digital currencies are commodities subject to its regulatory authority.[64] While the United States Securities & Exchange Commission (SEC) determined, in its now-familiar "DAO Report," that virtual currencies are securities subject to the Securities Act of 1933 and the Securities Exchange Act of 1934.[65]

Too, the few courts that have tackled the issue are a bit stuck on the classification quandary.[66] One recently observing the complicator that "several agencies may have concurrent regulatory authority in the cryptocurrency space."[67] Thus,

the fact that cryptocurrency may be regulated as an "investment contract" under the Securities Act of 1933, "does not mean that a cryptocurrency is not a 'commodity' within the meaning of the [Commodity Exchange Act or] CEA." [68]

In mid-2021, Congress introduced the Digital Asset Market Structure and Investor Protection Act—a bill providing for the regulation of digital assets and digital asset securities. [69] The proposed bill includes amendments to current federal securities laws and the CEA, defining and distinguishing a "digital asset" versus a "digital asset security" under the respective bodies of law. [70]

In short, under the proposed legislation, it appears a cryptocurrency's *characteristics* at a given time best determine whether it is subject to SEC or CFTC regulation ***299** (*e.g.*, an ICO is generally considered a security because its purpose, like an IPO, is to raise capital by selling new tokens or coins to investors). [71]

Within one-hundred-fifty (150) days of the bill's enactment, the SEC and CFTC are to jointly publish "a proposed rulemaking that classifies each of the major digital assets by (i) highest market capitalization and (ii) highest daily trading volume as either (1) a digital asset; or (2) a digital asset security." [72] Notably, in defining "major digital assets," the mandate refers the CFTC and SEC to "CoinMarketCap" as "an appropriate publicly available website" that publishes data on digital assets. [73]

C. THE SEC, *HOWEY*, AND CRYPTOCURRENCY AS AN INVESTMENT CONTRACT

The Securities Act of 1933 [74] and the Securities Exchange Act of 1934 [75] regulate the issuance and sales of investment products that qualify as securities under each Act. Congress's intent in enacting these laws "was to regulate *investments*, in whatever form they are made and by whatever name they are called." [76] This was to ensure the application of securities laws would "turn on the economic realities underlying a transaction, and not on the name appended thereto." [77]

Among many other investment-related terms, Section 77b(a)(1) of the 1933 Act defines a "security" to mean an "investment contract." [78] The United States Supreme Court animated those terms via the now well-accepted *Howey* test: an investment contract is "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." [79] This definition "embodies a flexible rather than a static principle, one that is capable of adaption to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." [80]

[2] Not surprisingly, courts have looked to *Howey* to ascertain whether cryptocurrencies qualify as an unconventional scheme or contract that is governed by securities laws. [81] "Whether a transaction or instrument qualifies as an investment contract is a highly fact-specific inquiry." [82] A court must "examine the series ***300** of understandings, transactions, and undertakings *at the time they were made*." [83] Accordingly, an application of the *Howey* test "requires an examination of the entirety of the parties' understandings and expectations." [84]

1. *Courts Applying* Howey *Have Determined Cryptocurrency is a Security.*

a. Investment of Money

[3] The first consideration under *Howey* is "whether an investment of money was part of the relevant transaction." [85] An investment of money "need not be made in cash and refers more generally to 'an arrangement whereby an investor commits assets to an enterprise or venture in such a manner as to subject himself to financial losses.' " [86] Several federal district courts have recently had occasion to apply *Howey* in digital currency contexts. And in each, the first prong was rather easily met.

For example, one court determined the plaintiff-investors' assets that were contributed in advance of a scheduled ICO—"even if such investments were in the form of cryptocurrencies"—was satisfactory. [87] In another similar matter, the plaintiff-investors' exchange of one form of cryptocurrency for a number of forthcoming digital coins that the defendant marketed and promised to distribute at its ICO event satisfied the investment-of-money prong. [88] And finally, this criterion was satisfied in yet another case

where the investors' initial contributions in the form of dollars and euros were in exchange for the future delivery of the defendants' soon-to-be-launched cryptocurrency. [89]

b. Common Enterprise

[4] **[5]** **[6]** The Court next looks to see if "a common enterprise exists where the 'fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment of third parties.' " [90] Often considered here is whether "horizontal commonality" or "vertical commonality" inheres in the arrangement. [91] Horizontal commonality requires one to show a "pooling" of the investors' interests or assets, such that all involved share in the profits and risks of the enterprise alike. [92] While vertical commonality "requires that the fortunes of investors be tied to the *fortunes* of the promoter." [93]

ICOs have constituted a common enterprise because the investees "pool" the contributed ***301** funds for the purpose of securing a profit for themselves and the investors, and the risks and benefits are shared equally among the parties. [94]

[7] **[8]** Horizontal commonality has been found to exist both before *and* after the launch of a defendant's cryptocurrency and blockchain platform. [95] Where one initially "pools" his investors' money in order to develop and launch a digital token and blockchain platform, he effectively renders his investors' profits entirely dependent upon the blockchain's successful launch. [96] If the launch is unsuccessful, the investors are equally affected and lose any opportunity to profit. [97] Horizontal commonality can also exist *post-launch* because the value of each token to be distributed thereafter is "dictated by the success [or failure] of the [blockchain] enterprise as a whole." [98] So the "plain economic reality" post-launch is that the distribution of the tokens continues to represent the investors' initial pooled funds. [99]

c. Expectation of Profits Derived Solely from the Efforts of Others

[9] **[10]** The final *Howey* factor is whether an investor entered into a transaction expecting to make a profit. "An investor possesses an expectation of profit when their motivation to partake in the relevant 'contract, transaction or scheme' was 'the prospects of a return on their investment.' " [100] A profit has been interpreted to mean an "income or return, to include, for example, dividends, other periodic payments, or the increased value of the investment." [101] Here, a court considers "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." [102]

[11] **[12]** This criterion is satisfied where investors' fortunes are "directly tied to the failure or success of the products the [investee] purport[s] to develop, and no individual investor c[an] exert control over the success or failure of his or her investment." [103] Indeed, an investor's expectation of profits relies on the "essential efforts" of investee when he or she wholly depends on that investee "to develop, launch, and support the [blockchain]." [104]

In finding whether investors were "led to expect profits solely from the efforts" of ***302** the investee-defendants, one court was particularly persuaded by the defendants' marketing materials. [105] In that case, the investors were induced by the defendants' marketing materials touting the potential profitability of their coins as well as their sole responsibility for developing and launching the blockchain platform—"the performance of which largely dictated the value of [the coins]." [106] Thus, it was the investee-defendants' "essential managerial efforts which affect the failure or success of the enterprise" that the investor-plaintiffs relied on to yield a return on their investment. [107]

D. "ID TOKENS" IS A SECURITY

Courts commonly classify a cryptocurrency as a security when the economic harm directly relates to or arises from its ICO. [108] The proposed federal legislation seeking to resolve the classification question, too, draws the line at the ICO. Just like any security, the purpose of an ICO is to *raise capital* by selling *new* coins or tokens to investors. Here, EverID's failure to distribute the due ID Tokens on the date of the ICO is the direct cause of the Plaintiffs' injury, *i.e.*, the ICO is the triggering event underlying this litigation.

Scrutiny under *Howey* of ID Tokens' characteristics, its distribution scheme, and the transaction mapped out by the Agreements leads inexorably to its classification as a security.

1. *ID Tokens is a Security Under* Howey.

At bottom, the Plaintiffs invested their expertise and proprietary resources to EverID's cryptocurrency enterprise, solely relying on EverID's development and management of the blockchain platform to yield a return on their investment.

a. Investment of Money

[13] To determine "whether an investment of money was part of the relevant transaction", [109] our courts have been clear that money *per se* isn't required to satisfy the first prong of *Howey*. [110] All that's required is an investor who "commits assets to an enterprise or venture in such a manner as to subject himself to financial losses." [111]

The Plaintiffs committed both an exclusive license to their ONYX software and related professional services to EverID's then-developing, blockchain-based cryptocurrency platform. In turn, the Plaintiffs elected to be paid in eventual token distributions rather than by traditional means—knowing full well that cryptocurrency value is ever-fluctuating. [112] The Plaintiffs "bore the risk of those fluctuations by ***303** agreeing to accept the cryptocurrency as payment instead of dollars" and subjected themselves to any attendant financial losses. [113] So, the first prong of *Howey* is satisfied here.

b. Common Enterprise

[14] "[A] common enterprise exists where the 'fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment of third parties.' " [114] EverID relied on the Plaintiffs' software license and professional services (*i.e.*, Plaintiffs' investments) to successfully develop and launch its blockchain platform. And in turn, the Plaintiffs' ability to recover any remuneration for their investment was interwoven with and wholly dependent upon the successful launch of EverID's blockchain. In other words, it was EverID's efforts—using Plaintiffs' investments—to develop a successful token that created a common enterprise.

It "is the nature of a common enterprise, to pool invested proceeds to increase the range of goods and services from which income and profits could be earned." [115] And the economic reality of this transaction—pre- and post-ICO—is that any future distribution, or continued growth of ID Tokens' value, is representative of the Plaintiffs' investments in EverID's blockchain platform. [116] The value of each subsequent token distribution is "dictated by the success of the [blockchain] enterprise as a whole." [117] And so, *Howey*'s common enterprise criterion is met.

c. Expectation of Profits Derived from the Efforts of Others

[15] The third *Howey* factor also exists here. No doubt, Plaintiffs had "an expectation of profit when their motivation" to enter into the negotiated Agreements was based on the promise of payment in the form of (and profit from) token distributions. [118] EverID's successful development and launch of the ID Tokens' enterprise was integral to the Plaintiffs' "prospects of a return on their investment." [119]

The Plaintiffs acquiesced to EverID's demand for an exclusive ONYX software license on the condition that EverID allocate and distribute a significant amount of ID Tokens at the ICO. The token grant wasn't in addition to payment for Plaintiffs' services, but rather *in lieu of* traditional compensation for their contributions to EverID. [120] Notwithstanding the attendant risks involved with cryptocurrency transactions, the substantial deferral of payment for their services, and the onerous distribution lock-up, the Plaintiffs reasonably believed this compensation arrangement would provide a proportional return of profit in relation to their initial investment.

Because the Plaintiffs could not be reimbursed until after EverID's initial ICO, their expected profits "were directly tied to the failure or success" of EverID's ***304** blockchain platform. [121] Their dependence on EverID "to develop, launch, and support the [blockchain]" is sufficient to find that the Plaintiffs' expectation of profits relied on the "essential efforts" of EverID. [122]

The economic reality of the parties' entire transaction here establishes each *Howey* factor. The Plaintiffs' overall investment into the platform was based on their expectation to be paid in eventual distributions of ID Tokens after the ICO. This expectation is no different than that of a traditional investment contract entered into before an IPO, and thus, ID Tokens is in this circumstance like a security. [123]

2. *Both License Agreements Expressly Require Adherence to SEC Regulatory Compliance.*

[16] **[17]** Delaware law governs the parties' respective License Agreements, [124] and in Delaware, a contract's proper construction is a question of law. [125] The goal of contract interpretation "is to fulfill the parties' shared expectations at the time they contracted." [126]

The parties took care to include language in *both* Agreements that token distributions were subject to regulatory compliance under Rule 144 of the Securities Act of 1933. [127] The Licensing Agreement also subjects token grants to "verification as an accredited investor, unless [User's Board], in its discretion, utilizes another valid exemption outside of, and separate from, its token offering under 506(c) such as Rule 701 ...." [128]

Because the Court's role is to "give priority to the parties' intentions as reflected in the four corners of the [A]greement," [129] it is manifest from each Agreement that the parties intended to treat the ID Tokens at each distribution as a security. Surely, it is not mere happenstance the parties included these references to SEC regulations in each Agreement.

The Agreements were signed almost one month apart, the later-signed Advisor Agreement doesn't mimic the terms of License Agreement, and both Agreements include language the other does not. Most notably, the provisions referencing the SEC regulations are phrased differently in each. This suggests nothing other than the parties deemed it prudent to include the ***305** regulatory compliance references in both Agreements and anticipated treating the ICO and forthcoming distributions like those of a security.

III. DAMAGES

[18] **[19]** **[20]** "Under Delaware law, the standard remedy for breach of contract is based on the reasonable expectations of the parties that existed before or at the time of the breach." [130] It is well-settled that breach of contract damages "are designed to place the injured party ... in the same place as he would have been if the contract had been performed. Such damages should not act as a windfall." [131] Accordingly, when assessing such damages, "the non-breaching party is entitled to recover 'damages that arise naturally from the breach or that were reasonably foreseeable at the time the contract was made.' " [132]

But in a case such as this—where the damages were unforeseeable at the time of contracting and it cannot be determined what the Plaintiffs would have received had the contract been performed—how does the Court fashion a reasonable remedy that accounts for: (1) the volatile and unregulated nature of cryptocurrency; (2) the express terms of the Agreements requiring immediate distribution of 25% of the total token grant at the ICO (a concrete and discernible amount); and (3) the remaining periodic token distributions whose values are so unpredictable that a blanket damages calculation indeed could operate as a windfall?

The damages calculation here is two-fold. First, the Court must find a reliable cryptocurrency valuation source to ensure the proper input of values. Then the Court must ascertain the proper method for calculating the damages such that it will place the Plaintiffs in the same position they would have been had the Agreements been fully performed.

A. PROPER VALUATION SOURCE – COINMARKETCAP

[21] The few courts that have endeavored to do so have found CoinMarketCap to be a "reliable valuation tool" for determining the USD value of cryptocurrency tokens. [133] As one rightly observed, "CoinMarketCap is used frequently by news publications to report on prices of virtual currencies, including publications that focus on virtual currencies such as CoinDesk and general financial newspapers like the Wall Street Journal and the Financial Times." [134]

Tellingly, Congress's proposed Digital Asset Market Structure and Investor Protection Act encourages the SEC and CFTC

to publish joint rulemaking concerning ***306** digital asset classification. [135] And in so doing, it nods to CoinMarketCap as "an appropriate publicly available website ... that publishes" data on digital assets. [136]

Against this backdrop, the Court is satisfied CoinMarketCap is a reliable cryptocurrency valuation tool. As such, the Court will rely on historical pricing data published by CoinMarketCap to determine the proper USD value of ID Tokens in calculating the Plaintiffs' forthcoming judgment.

B. PROPER VALUATION METHOD

The Plaintiffs posit EverID's failure to distribute the ID Tokens is analogous to Delaware's "failure to deliver securities" cases, where damages are determined by the highest market price of the security within a reasonable time of a plaintiff's discovery of the breach. [137]

Just so. But for the novelty of the subject instrument being units of cryptocurrency this suit mirrors any other failure to deliver securities case—a run-of-the-mill action for Delaware courts. The Court will, therefore, calculate the Plaintiffs' forthcoming judgment applying established Delaware precedent.

1. *Highest Value Within a Reasonable Time.*

Known as the New York Rule, the "highest value within a reasonable time" framework is a judicially-created breach-of-contract remedy for reckoning "damages where stock or 'properties of like character' were converted, not delivered according to contractual or other legal obligation, or otherwise improperly manipulated." [138] It's frequently employed in wrongful stock conversion litigation and measures damages by: "the highest intermediate value reached by the stock between the time of the wrongful act complained of and a reasonable time thereafter, to be allowed to the party injured to place himself in the position he would have been in had not his rights been violated." [139]

This slight variation of the old English rule—which measured damages by the highest value of the stock on or before the day of trial [140] —allows for a more just recovery. [141] The rule was modified in an effort to alleviate the drastic fluctuating values of the asset—yet another a hardship borne by the victim—since trial was an event that often occurred long after the conversion. [142] So in the case of volatile-stock values, the modification allows recovery for those "profits possibly lost as a result of the wrongful conduct." [143]

***307** For practical reasons, the modified rule doesn't require the injured party to "reenter the market." [144]

> The value of lost securities may rise dramatically the day after a wrongful conversion and then embark on a prolonged downward spiral. Had the owner of such securities not been wrongfully parted with them, he might well have been prompted to sell them within a few days, as their value began to plummet. To require him actually to reenter the market and repurchase the same securities as a predicate for a damage claim, when steadily falling prices render such an investment imprudent, would frustrate the rule which seeks to make an investor whole. Rather than mitigating damages, as this example illustrates, a requirement that there be an actual repurchase could result in an *increase* in damages. [145]

But the rule is careful to avoid windfall awards to injured parties. Should the highest value occur *after* the stock has been converted, but *before* the injured party learns of the conversion, he cannot rely on that value for his damages. [146] No, the injured party's "reasonable time" period begins *after or upon* the date the conversion is discovered. [147]

[22] Accordingly, the measure of damages for wrongful conversion of stock or properties of like character is the higher value of either: "(1) its value at the time of conversion or (2) its highest intermediate value between notice of the conversion and a reasonable time thereafter during which the stock could have been replaced ...." [148]

2. Delaware Follows the New York Rule.

Our Court of Chancery adopted the New York rule in *American Gen. Corp. v. Continental Airlines Corp.*, where it was asked to determine the value of damages for improperly converted stock options. [149]

There, the plaintiffs recommended "a variation of the damage formula used in cases involving the conversion of securities of fluctuating value ... [that is] based on the highest market price the stock reached within a reasonable time of plaintiff's discovery of the breach." [150] The court accepted the recommended "highest market price of the stock" approach, but modified the amount because the date the plaintiffs used was arbitrary and self-serving. [151] Instead, the court used the date the plaintiff's became absolutely entitled to be issued the options because that was the date the stockholders "approved the Employee Option" at issue in the litigation. [152]

[23] Now, "[w]hat constitutes a reasonable period of time is a question of law for the court to determine." [153] A plaintiff can't cherry-pick dates to trump up the maximal value. [154] "Rather, the date should be established by resort to a 'constructive replacement' purchase by the plaintiff, *i.e.*, how long it would have taken the plaintiff to ***308** replace the securities on the open market." [155] Two or three months has been accepted as a reasonable period of time to replace an asset on the open market. [156]

C. APPLICATION OF METHOD AND SOURCE

[24] The Court is satisfied that the New York Rule is the proper method, and CoinMarketCap is the proper valuation source, to calculate the Plaintiffs' damages. Too, the Court is satisfied this approach best represents the parties' intentions at the time of contracting. [157] So Diamond Fortress's and Mr. Hatcher's damages will be calculated by multiplying the total tokens awarded under the respective Agreements by ID Tokens' highest intermediate value within three months of the discovery of EverID's breach.

[25] Between the ICO date of February 8, 2021, and through March 4, 2021, the Plaintiffs attempted to contact EverID to discuss then-due token distributions and obtain adequate assurances of payment. After hearing crickets, the Plaintiffs sent their final communication to EverID on March 4, 2021, declaring their intent to treat the Agreement as breached and to pursue legal remedies. March 4 is therefore the date the Plaintiffs became absolutely entitled to issuance of their ID Tokens. Hence, the proper three-month "reasonable time" period ran from March 4, 2021, to June 3, 2021.

CoinMarketCap recorded and published the daily values of ID Tokens during that March 4, 2021 to June 3, 2021 span. The highest market price within that time period was recorded on April 9, 2021, at a value of 2.01 USD. [158]

Consequently, the Plaintiffs' base damages are calculated as follows:

	DIAMOND FORTRESS TECHNOLOGIES	CHARLES HATCHER, II
Total Tokens Awarded	10,000,000	2,500,000
Highest Value of ID Tokens from 3/4/2021–6/3/2021	$2.01	$2.01
TOTAL BASE DAMAGES TO BE AWARDED	**$20,100,000.00**	**$5,025,000.00**

Plaintiffs are also awarded pre-judgment interest on the above total figures, at ***309** the statutory rate accruing from March 4, 2021, the date they became absolutely entitled to the token distributions, until the entry date of this Opinion and Order. [159] Plaintiffs are further entitled to post-judgment

interest, again at the statutory rate, accruing as of the entry date of this Opinion and Order. [160]

IV. CONCLUSION

For reasons set forth herein, judgment for both Diamond Fortress and Mr. Hatcher shall be entered accordingly. Within 20 days of entry of this Opinion and Order, their counsel shall submit to the Court a proposed form of final judgment that incorporates the Court's award, including pre- and post-judgment calculations.

IT IS SO ORDERED.

All Citations

274 A.3d 287

Footnotes

1 The factual recitation of events discussed herein is wholly based on the Plaintiffs' submissions. *See Hauspie v. Stonington Partners, Inc.*, 945 A.2d 584, 586 (Del. 2008) ("The effect of a default in answering [ ] is to deem admitted all the well-pleaded facts in the complaint."); *id.* at 587 (" '[A] default is not treated as an absolute confession by the defendant of his liability and of the plaintiff's right to recover ... Although he may not challenge the sufficiency of the evidence ....' ") (quoting *Nishimatsu Const. Co., Ltd. v. Houston Nat. Bank*, 515 F.2d 1200, 1206 (5th Cir. 1975)); *see also Cigna Worldwide Ins. Co. v. Elegant Inc.*, 2002 WL 1402348, at *2 (D. Del. June 25, 2002) ("Once the default [judgment] has been entered, the well-pleaded facts of the complaint must be accepted as true.").

2 Compl. ¶¶ 4, 10, *Diamond Fortress Technologies, Inc. v. EverID, Inc.*, N21C-05-048 PRW CCLD, May 4, 2021 (D.I. 1).

3 *Id.* ¶¶ 1, 21.

4 *Id.* ¶ 10.

5 *Id.*

6 *Id.*

7 *Id.* ¶¶ 1, 12.

8 *Id.* ¶ 6.

9 *Id.* ¶ 11.

10 *Id.*

11 *Id.*

12 *Id.* ¶ 21.

13 *Id.* ¶ 13.

14 *See S.E.C. v. Shavers*, 2014 WL 12622292, at *7 (E.D. Tex. Aug. 26, 2014) (holding cryptocurrency investments offered by the defendant qualified as "securities" and "investment contracts").

15 Compl. ¶ 13.

16 Compl., Ex. A, ONYX Software Development Kit License Agreement, § 3.1(c)(i) ("License Agreement").

17 Compl. ¶ 12.

18 *Id.*

19 *Id.*

20 Compl., Ex. A, License Agreement.

21 *Id.* §§ 11, 17.

22 *Id.* § 3.1(a). The record is unclear whether this payment was ever tendered.

23 *Id.* § 3.1(b).

24 *Id.* § 3.1(c)(i).

25 *Id.* § 3.1(c)(ii) (emphasis added).

26 Compl., Ex. B, Advisor Agreement.

27 *Id.* §§ 1, 5.

28 *Id.* § 2.

29 *Id.* (emphasis added).

30 *Id.; see also* License Agreement § 3.1(c)(iii) ("[T]he foregoing grants of tokens are subject to ... (c) regulatory compliance including, but not limited to, lock-ups and restrictions, including but not limited to Rule 144 Restrictions ....").

31 Damages Hr'g Tr., 3-4, *Diamond Fortress Technologies, Inc. v. EverID, Inc.*, N21C-05-048 PRW CCLD, Oct. 28, 2021 (D.I. 27).

32 *Id.* at 4; *see also* Pls.' Mot. for Default J. ¶ 21, *Diamond Fortress Technologies, Inc. v. EverID, Inc.*, N21C-05-048 PRW CCLD, July 16, 2021 (D.I. 12).

33 Hr'g Tr. at 5; *see also* Compl. ¶¶ 30-32.

34 *See generally* Compl.

35 D.I. 12.

36 *Campbell v. Robinson*, 2007 WL 1765558, at *1 n.6 (Del. Super. Ct. June 19, 2007) (citing Del. Super. Ct. Civ. R. 55(b)(2)).

37 Order Granting Pls.' Mot. for Default J. in Part ¶¶ 2-3, *Diamond Fortress Technologies, Inc. v. EverID, Inc.*, N21C-05-048 PRW CCLD, Aug. 24, 2021 (D.I. 17); *see also* Hr'g Tr. at 7, 12-15.

38 *BioVeris Corp. v. Meso Scale Diagnostics, LLC*, 2017 WL 5035530, at *8 (Del. Ch. Nov. 2, 2017), *aff'd*, 2019 WL 244619 (Del. Jan. 17, 2019).

39 *Id.*

40 *Id.* at *9 (quoting 9 Arthur Linton Corbin, *Corbin on Contracts* § 954 (interim ed. 2002) (citations omitted)); 10 John E. Murray, Jr., *Corbin on Contracts* § 53.12 (Joseph M. Perillo, ed., rev. ed. 2014) (internal citations omitted)).

41 *See*, *e.g.*, *Frontier Oil Corp. v. Holly Corp.,* 2005 WL 1039027, at *28 n.184 (Del. Ch. Apr. 29, 2005) (relying on the Restatement regarding "the nature of a demand for adequate assurances[.]").

42 *Restatement (Second) of Contracts*, § 251 (1981).

43 *BioVeris Corp.*, 2017 WL 5035530, at *8 (emphasis added); *see also Mumford v. Long,* 1986 WL 2249, at *3 (Del. Ch. Feb. 21, 1986) (holding where repudiation is found "the non-breaching party is entitled to treat the contract as terminated, *i.e.*, as being at an end").

44 Order Granting Pls.' Mot. for Default J. in Part ¶¶ 2-3.

45 *Campbell*, 2007 WL 1765558, at *1 n.6 (citing Del. Super. Ct. Civ. R. 55(b)(2)).

46 *Id* at n.7.; *see also Dill v. Dill*, 2016 WL 4127455, at *1 (Del. Super. Ct. Aug. 2, 2016) ("After a default judgment is ordered, an inquisition hearing is held to determine the amount of damages due. At an inquisition hearing, the Court's findings on damages must be based on a preponderance of the evidence. The 'sole focus of inquisition hearings is the amount of damages owed to the plaintiff, which is determined by the ... judge.' Preponderance of the evidence means 'the side on which the greater weight of the evidence is found.' Additionally, the standard remedy, or damages, for a breach of contract is based upon the reasonable expectations of the parties, in an amount that is equal to the loss in value of defendant's nonperformance, or breach. Damages for a breach of contract must be proven with reasonable certainty. Recovery is not available to the extent that the alleged damages are uncertain, contingent, conjectural, or speculative.") (internal citations omitted).

47 D.I. 21.

48 *Archer v. Coinbase, Inc.*, 53 Cal.App.5th 266, 267 Cal. Rptr. 3d 510, 513 (2020).

49 *Blocktree Props., LLC v. Pub. Util. Dist. No. 2 of Grant Cnty. Washington*, 380 F. Supp. 3d 1102, 1110 (E.D. Wash. 2019).

50 *Balestra v. Giga Watt, Inc.*, 2018 WL 8244006, at *1 (E.D. Wash. June 18, 2018).

51 *Id.*

52 *Zietzke v. United States*, 2020 WL 264394, at *1 (N.D. Cal. Jan. 17, 2020).

53 Josephine Shawver, *Commodity or Currency: Cryptocurrency Valuation in Bankruptcy and the Trustee's Recovery Powers*, 62 B.C. L. REV. 2013, 2018 (2021).

54 *Zietzke*, 2020 WL 264394, at *1.

55 Shawver, *supra* at 2021.

56 *Id.* at 2022.

57 *Id*.

58 Larissa Lee, *New Kids on the Blockchain: How Bitcoin's Technology Could Reinvent the Stock Market*, 12 HASTINGS BUS. L.J. 81, 90 (2016).

59 *BDI Cap., LLC v. Bulbul Invs. LLC*, 446 F. Supp. 3d 1127, 1131 n.3 . (N.D. Ga. 2020). *See also United Am. Corp. v. Bitmain, Inc.*, 530 F. Supp. 3d 1241, 1251 (S.D. Fla. 2021) (where one litigant characterized Bitcoin as "the most widely adopted form of peer-to-peer cryptocurrency cash-like system in the world.").

60 *Kleiman v. Wright*, 2018 WL 6812914, at *1 (S.D. Fla. Dec. 27, 2018).

61 *Id.*

62 *Id.*

63 *See* Shawver, *supra* at 2021.

64 *CFTC v. McDonnell*, 287 F. Supp. 3d 213, 226 (E.D.N.Y. 2018) *adhered to on denial of reconsideration*, 321 F. Supp. 3d 366 (E.D.N.Y. 2018).

65 *Tetragon Fin. Grp. Ltd. v. Ripple Labs Inc.*, 2021 WL 1053835, at *7, n.87 (Del. Ch. Mar. 19, 2021) (citing SEC, REPORT OF INVESTIGATION PURSUANT TO SECTION 21(A) OF THE SECURITIES EXCHANGE ACT OF 1934: THE DAO (2017), https://www.sec.gov/litigation/investreport/34-81207.pdf).

66 *See McDonnell*, 287 F. Supp. 3d at 217 (holding virtual currencies are commodities subject to CFTC regulatory protections); *Lagemann v. Spence*, 2020 WL 5754800, at *11-12 (S.D.N.Y. May 18, 2020) (holding that plaintiffs had established their right to a judgment under the CEA after the defendant misappropriated their cryptocurrency investments); *CFTC v. Gelfman Blueprint, Inc.*, 2018 WL 6320653, at *4 (S.D.N.Y. Oct. 2, 2018) (holding virtual currencies are encompassed in the definition of commodity under the Commodity Exchange Act); *contra S.E.C. v. Kik Interactive Inc.*, 492 F. Supp. 3d 169 (S.D.N.Y. 2020) (holding that a company's public sale of virtual currency was an investment contract subject to SEC registration requirements); *Balestra v. ATBCOIN LLC*, 380 F. Supp. 3d 340 (S.D.N.Y. 2019) (holding that digital tokens are considered securities).

67 *United States v. Samuel Reed*, 2022 WL 597180, *4 (S.D.N.Y. Feb. 28, 2022).

68 *Id.*

69 Digital Asset Market Structure and Investor Protection Act, H.R. 4741, 117th Cong. (2021).

70 *Id.*

71 Eva Su, *Digital Assets and SEC Regulation*, CONGRESSIONAL RESEARCH SERVICE (June 23, 2021) https://sgp.fas.org/crs/misc/R46208.pdf ("When a digital asset meets the criteria defining a security, it would be subject to securities regulation, per existing SEC jurisdiction. For example, most of the initial coin offerings (ICOs) are securities, but Bitcoin is not a security, mainly because it does not have a central third-party common enterprise.").

72 *See* HR 4741.

73 *Id.* As of the date of this Opinion, the proposed legislation has yet to be enacted.

74 15 U.S.C. § 77a *et seq*.

75 15 U.S.C. § 78a *et seq.*

76 *S.E.C. v. Edwards*, 540 U.S. 389, 393, 124 S.Ct. 892, 157 L.Ed.2d 813 (2004) (quoting *Reves v. Ernst & Young*, 494 U.S. 56, 61, 110 S.Ct. 945, 108 L.Ed.2d 47 (1990)) (emphasis in original).

77 *United Housing Found., Inc. v. Forman*, 421 U.S. 837, 849, 95 S.Ct. 2051, 44 L.Ed.2d 621 (1975).

78 15 U.S.C. § 77b(a)(1) (2021) (Definitions; promotion of efficiency, competition, and capital formation).

79 *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 298-99, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946).

80 *Id.* at 299, 66 S.Ct. 1100.

81 *See, e.g.*, *S.E.C. v. Telegram Grp. Inc.*, 448 F. Supp. 3d 352, 364–65 (S.D.N.Y. 2020).

82 *United States v. Zaslavskiy*, 2018 WL 4346339, at *4 (E.D.N.Y. Sept. 11, 2018).

83 *Telegram*, 448 F. Supp. 3d at 368 (emphasis added).

84 *See id*. at 379 (citing *Howey*, 328 U.S. at 297-98, 66 S.Ct. 1100).

85 *Id*. at 368.

86 *Hodges v. Harrison*, 372 F. Supp. 3d 1342, 1348 (S.D. Fla. 2019) (quoting *S.E.C. v. Friendly Power Co. LLC*, 49 F. Supp. 2d 1363, 1368-69 (S.D. Fla. 1999)); *see also Uselton v. Comm. Lovelace Motor Freight, Inc.,* 940 F.2d 564, 574 (10th Cir. 1991) ("[I]n spite of *Howey's* reference to an 'investment of money,' it is well established that cash is not the only form of contribution or investment that will create an investment contract.").

87 *Hodges*, 372 F. Supp. 3d at 1348.

88 *Balestra v. ATBCOIN LLC*, 380 F. Supp. 3d 340, 347, 353 (S.D.N.Y. 2019).

89 *Telegram*, 448 F. Supp. 3d at 368-69.

90 *Hodges*, 372 F. Supp. 3d at 1348 (quoting *S.E.C. v. Unique Fin. Concepts, Inc.*, 196 F.3d 1195, 1199 (11th Cir. 1999)).

91 *Telegram*, 448 F. Supp. 3d at 369.

92 *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994).

93 *Id*. at 88 (emphasis in original); *see also In re J.P. Jeanneret Assocs.*, 769 F. Supp. 2d 340, 360 (S.D.N.Y. 2011) (holding "that strict vertical commonality (like horizontal commonality) is sufficient to establish a common enterprise under *Howey*").

94 *Hodges*, 372 F. Supp. 3d at 1348.

95 *Telegram*, 448 F. Supp. 3d at 369-70; *see also* *Balestra*, 380 F. Supp. 3d at 353-54 (plaintiffs plausibly demonstrated the "pooling of the investors' funds" because the "Defendants encouraged investors to purchase ATB Coins based on the claim that the speed and efficiency of the ATB Blockchain would result in an increase in the coins' value"); *Revak*, 18 F.3d at 87 (holding "horizontal commonality" exists where the investors' profits are tied "to the success of the overall venture").

96 *Telegram*, 448 F. Supp. 3d at 369-70.

97 *Id.*

98 *Id.* at 370.

99 *Id.* at 369; *see also* *Balestra*, 380 F. Supp. 3d at 354 (finding a pooling of investments after the launch of a digital asset).

100 *Telegram*, 448 F. Supp. 3d at 371 (citing *Howey*, 328 U.S. at 301, 66 S.Ct. 1100).

101 *S.E.C. v. Edwards*, 540 U.S. 389, 394, 124 S.Ct. 892, 157 L.Ed.2d 813 (2004).

102 *Bamert v. Pulte Home Corp.*, 445 F. App'x. 256, 262 (11th Cir. 2011) (quoting *S.E.C. v. Glenn W. Turner Enters., Inc.*, 474 F.2d 476, 482 (9th Cir. 1973)).

103 *Hodges*, 372 F. Supp. 3d at 1348.

104 *Telegram*, 448 F. Supp. 3d at 375-79 (holding the totality of the evidence and economic realities indicate that defendants' initial sales of the coins were part of a larger scheme, manifested by its "actions, conduct, statements, and understandings ... with the intent and purpose that the [coins] be distributed in a secondary public market, which is the offering of securities under *Howey*").

105 *Balestra*, 380 F. Supp. 3d at 357.

106 *Id.*

107 *Id.* at 355-57.

108 *See* *S.E.C. v. Kik Interactive Inc.*, 492 F. Supp. 3d 169 (S.D.N.Y. 2020) (holding that a company's public sale of virtual currency was an investment contract subject to SEC registration requirements); *see also* *Balestra*, 380 F. Supp. 3d 340 (S.D.N.Y. 2019); *Telegram*, 448 F. Supp. 3d 352 (S.D.N.Y. 2020); *Hodges v. Harrison*, 372 F. Supp. 3d 1342 (S.D. Fla. 2019).

109 *Telegram*, 448 F. Supp. 3d at 368.

110 *Uselton v. Comm. Lovelace Motor Freight, Inc.*, 940 F.2d 564, 574 (10th Cir. 1991).

111 *S.E.C. v. Friendly Power Co. LLC*, 49 F. Supp. 2d 1363, 1368-69 (S.D. Fla. 1999).

112 Hr'g Tr. at 10.

113 *Id.*

114 *Hodges*, 372 F. Supp. 3d at 1348 (quoting *S.E.C. v. Unique Fin. Concepts, Inc.*, 196 F.3d 1195, 1199 (11th Cir. 1999)).

115 *Kik Interactive Inc.*, 492 F. Supp. 3d at 179.

116 *See* *Balestra*, 380 F. Supp. 3d at 354 (finding a pooling of investments *after* the launch of a digital asset).

117 *Id.*

118 *Telegram*, 448 F. Supp. 3d at 371 (citing *Howey*, 328 U.S. at 301, 66 S.Ct. 1100).

119 *Id.*

120 *See generally* License and Advisor Agreements.

121 *Hodges*, 372 F. Supp. 3d at 1348.

122 *Telegram*, 448 F. Supp. 3d at 375-79.

123 *Id.* at 379 (citing *Howey*, 328 U.S. at 297-98, 66 S.Ct. 1100) (requiring "an examination of the entirety of the parties' understandings and expectations").

124 Compl., Ex. A, License Agreement § X2-6.3.

125 *Exelon Generation Acquisitions, LLC v. Deere & Co.*, 176 A.3d 1262, 1266–67 (Del. 2017).

126 *Leaf Invenergy Co. v. Invenergy Renewables LLC*, 210 A.3d 688, 696 (Del. 2019) (internal quotation marks omitted).

127 Compl., Ex. B, Advisor Agreement; *see also id.* at Ex. A, License Agreement § 3.1(c)(iii) ("[T]he foregoing grants of tokens are subject to ... (c) regulatory compliance including, but not limited to, lock-ups and restrictions, including but not limited to Rule 144 Restrictions ....").

128 *Id.*, Ex. A, License Agreement § 3.1(c)(iii). Rule 506(c) is the S.E.C.'s "small business exempt offerings" rule that governs general solicitations and advertisements of a public offering. *See* U.S. SECURITIES AND EXCHANGE COMM'N, GENERAL SOLICITATION-RULE 506(C) (2022), https://www.sec.gov/smallbusiness/exemptofferings/rule506c.

129 *In re Viking Pump, Inc.*, 148 A.3d 633, 648 (Del. 2016) (internal quotation marks omitted).

130 *Siga Tech., Inc. v. PharmAthene, Inc.*, 132 A.3d 1108, 1132-33 (Del. 2015) (citing *Duncan v. Theratx, Inc.*, 775 A.2d 1019, 1022 (Del. 2001)).

131 *Paul v. Deloitte & Touche, LLP*, 974 A.2d 140, 146 (Del. 2009).

132 *Id.* (quoting *Tackett v. State Farm Fire & Cas. Ins. Co.*, 653 A.2d 254, 264–65 (Del.1995)).

133 *CFTC v. McDonnell*, 332 F. Supp. 3d 641, 670–71 (E.D.N.Y. 2018); *CFTC v. Reynolds*, 2021 WL 796683, at *4 n.2 (S.D.N.Y. Mar. 2, 2021) (citing *McDonnell*, 332 F. Supp. 3d at 670–71) (holding "CoinMarketCap is a reliable valuation tool for these purposes"); *Hodges v. Harrison*, 372 F. Supp. 3d 1342, 1353 n.1 (S.D. Fla. 2019) (holding an evidentiary hearing "to determine the appropriate manner of calculating the value of Plaintiffs investments" before determining CoinMarketCap was a reliable source to convert cryptocurrency into USD).

134 *McDonnell*, 332 F. Supp. 3d at 670–71.

135 Digital Asset Market Structure and Investor Protection Act, H.R. 4741, 117th Cong. (2021).

136 *Id.*

137 Pls.' Mot. for Default J. ¶ 28 (citing *Am. Gen. Corp. v. Cont'l Airlines Corp.*, 622 A.2d 1 (Del. Ch. 1992)).

138 *Schultz v. CFTC*, 716 F.2d 136, 141 (2d Cir. 1983) (citing *McKinley v. Williams*, 74 F. 94, 103 (8th Cir. 1896)).

139 *Id.* at 139-40 (quoting *Galigher v. Jones*, 129 U.S. 193, 200, 9 S.Ct. 335, 32 L.Ed. 658 (1889)); *see also McKinley*, 74 F. at 102-03 (holding the "true and just measure of damages" is "the highest intermediate value of the stock between the time of its conversion and a reasonable time after the owner has received notice of it to enable him to replace the stock").

140 *Galigher*, 129 U.S. at 201, 9 S.Ct. 335.

141 *Schultz*, 716 F.2d at 140.

142 *Id.*

143 *Id.*

144 *Id.*

145 *Id.* (emphasis in original).

146 *Id.* at 140-41.

147 *Id.* at 141.

148 *Id.* at 141.

149 622 A.2d 1 (Del. Ch. 1992).

150 *Id.* at 8.

151 *Id.* at 11-13.

152 *Id.* at 8, 14.

153 *Segovia v. Equities First Holdings, LLC*, 2008 WL 2251218, *21 (Del. Super. Ct. May 30, 2008).

154 *Am. Gen. Corp*, 622 A.2d at 13.

155 *Id.* (citing *Madison Fund, Inc. v. Charter Co.*, 427 F. Supp. 597, 609 (S.D.N.Y. 1977)).

156 *Segovia,* 2008 WL 2251218, at *22 (finding three months was appropriate for determining damages); *see also Comrie v. Enterasys Networks, Inc.*, 837 A.2d 1, 20 (Del. Ch. 2003) (calculating damages within a 90-day period because the parties' agreement gave the plaintiff ninety days from date of vesting to sell the disputed shares); *Galigher v. Jones*, 129 U.S. 193, 199-200, 9 S.Ct. 335, 32 L.Ed. 658 (1889) (affirming two-months' time was appropriate for calculating damages).

157 *See* Compl., Ex. A, License Agreement at § 3.1(c)(i) (containing unambiguous references to SEC regulatory compliance).

158 Pls.' Suppl. Submission in Supp. of Mot. for Default J., Ex. A, CoinMarketCap "Historical Data for Everest" (https://coinmarketcap.com/currencies/everest/historical-data/).

159 *See* DEL. CODE ANN. tit. 6, § 2301 (2012); *see also Brandywine Smyrna, Inc. v. Millennium Builders, LLC*, 34 A.3d 482, 486 (Del. 2011) (holding that "prejudgment interest in Delaware cases is awarded as a matter of right").

160 *See Wilmington Country Club v. Cowee*, 747 A.2d 1087, 1097 (Del. 2000) (observing that post-trial interest "is a right belonging to the prevailing plaintiff and is not dependent upon the trial court's discretion").

End of Document

TAB 39

BDI Cap., LLC v. Bulbul Invs. LLC, 446 F. Supp. 3d 1127, 1140–41 (N.D. Ga. 2020)

446 F.Supp.3d 1127
United States District Court,
N.D. Georgia, Atlanta Division.

BDI CAPITAL, LLC, Plaintiff,
v.
BULBUL INVESTMENTS LLC d/b/
a Campbx, Keyur Mithawala Defendants.

CIVIL ACTION NO. 1-18-cv-3392-AT
|
Signed 03/11/2020

Synopsis

Background: Owner of cryptocurrency brought action against operator of cryptocurrency exchange, alleging that operator unlawfully retained owner's cryptocurrency, and asserting claims for violations of the Commodities Exchange Act and for conversion, unjust enrichment, and negligent and fraudulent misrepresentation under Georgia law. Operator filed motion for summary judgment.

Holdings: The District Court, Amy Totenberg, J., held that:

[1] owner could not recover under Commodities Exchange Act;

[2] cryptocurrency was proper of subject of conversion claim under Georgia law;

[3] fact issues precluded summary as to conversion claim concerning owner's primary cryptocurrency;

[4] operator had no duty to warn owner that it would not support "forked" cryptocurrency;

[5] owner's conversion claim as to forked cryptocurrency was precluded under Georgia law;

[6] fact issues precluded summary judgment as to claim for unjust enrichment; and

[7] fact issues precluded summary judgment as to negligent and fraudulent misrepresentation claims.

Motion granted in part and denied in part.

Procedural Posture(s): Motion for Summary Judgment.

West Headnotes (14)

[1] **Federal Civil Procedure** Failure to Comply; Sanctions

Purported failure of operator of cryptocurrency exchange to produce during discovery records showing the absence of operator's communications with cryptocurrency owner did not preclude exchange from offering evidence of such absence on motion for summary judgment; rules governing a party's duty to disclose and production of documents did not require a party to produce all of its records to prove the absence of a record, but instead the party needed only to state that a diligent search was performed and no such records were located. Fed. R. Civ. P. 26(b)(1), 34(b), 37(c)(1).

[2] **Commodity Futures Trading Regulation** Options; deferred delivery or futures contracts

The Commodity Exchange Act regulates those who participate in transactions involving commodities futures. Commodity Exchange Act § 1 et seq., 7 U.S.C.A. § 1 et seq.

[3] **Commodity Futures Trading Regulation** Right or cause of action

Cryptocurrency owner could not recover from operator of cryptocurrency exchange under section of the Commodities Exchange Act governing private rights of action for damages allegedly incurred in connection with owner's purchase of, and subsequent inability to withdraw, its cryptocurrency; operator provided no trading advice for a fee, owner did not enter into a contract to purchase cryptocurrency at a specific date in the future, and section's provision authorizing claims based on contracts subject to another section of the Act dealing with unregulated margin accounts and leverage contracts for commodities did not apply.

Commodity Exchange Act §§ 19, 22, 7 U.S.C.A. §§ 23(a, b), 25.

1 Case that cites this headnote

[4] **Conversion and Civil Theft** 🔑 Intangible and intellectual property in general

Under Georgia law, conversion is not available as a cause of action with respect to intangible property representing an interest in a business.

[5] **Conversion and Civil Theft** 🔑 Intangible and intellectual property in general

Conversion and Civil Theft 🔑 Money and commercial paper; debt

Under Georgia law, specific intangible property may be the subject for an action for conversion, but, as fungible intangible personal property, money, generally, is not subject to a civil action for conversion.

[6] **Conversion and Civil Theft** 🔑 Money and commercial paper; debt

Under Georgia law, as predicted by a federal district court, a cryptocurrency was sufficiently identifiable to be considered specific intangible property subject to an action for conversion.

[7] **Conversion and Civil Theft** 🔑 Questions for jury

Summary Judgment 🔑 Conversion and civil theft

Genuine issues of material fact as to whether or when demands for possession of cryptocurrency were made, the intent of operator of cryptocurrency exchange, whether operator's explanation for failing to respond promptly to letter sent by cryptocurrency owner's counsel was a factually and legally justifiable defense, and whether the exchange's purported terms of service applied and limited owner's damages precluded summary judgment for operator as to owner's conversion claim under Georgia law alleging operator's failure to return the cryptocurrency upon demand by owner. Fed. R. Civ. P. 56(c).

[8] **Brokers** 🔑 Custody and care of principal's property and funds

Brokers 🔑 Conversion

Under Georgia law governing stockbrokers, a cash customer, as distinguished from one who has purchased stock on margin, is entitled to the delivery of stock purchased for him, and, in the absence of an agreement or instructions to the contrary, the broker undertakes and agrees to deliver the stock to the customer either immediately or in such time as is necessary to effectuate the transfer and is reasonable under the circumstances; if a broker refuses to make delivery upon demand, he is liable for conversion.

[9] **Conversion and Civil Theft** 🔑 Withholding of possession

Securities Regulation 🔑 Broker-dealers, agents, and investment advisers

Under Georgia law, as predicted by a federal district court, operator of cryptocurrency exchange did not have an affirmative obligation to warn cryptocurrency owner in advance that it would not be supporting a particular "forked" cryptocurrency, i.e., a new cryptocurrency based on the blockchain ledger of an existing cryptocurrency, as relevant to owner's conversion claim alleging operator's unlawful retaining of forked cryptocurrency created while owner's primary cryptocurrency was on the exchange; under Georgia law, stockbrokers had no duty to advise clients of a pending stock split or dividend before processing a sale order, and Georgia appellate courts likely would have extended this logic to the context of cryptocurrency forks.

1 Case that cites this headnote

[10] **Conversion and Civil Theft** 🔑 Withholding of possession

No evidence supported inference that operator of cryptocurrency exchange voluntarily undertook to support a particular "forked" cryptocurrency, i.e., a new cryptocurrency based on the blockchain ledger of an existing cryptocurrency, thus precluding cryptocurrency owner's conversion claim under Georgia law, alleging operator's unlawful retaining of forked cryptocurrency created while owner's primary cryptocurrency was on the exchange.

1 Case that cites this headnote

[11] **Implied and Constructive Contracts** Questions for jury

Summary Judgment Unjust enrichment and contracts implied in law

Genuine issues of material fact as to whether operator of cryptocurrency exchange received any benefit above and beyond its trading fees and the applicability of its terms of service precluded summary judgment in favor of operator as to cryptocurrency owner's claim for unjust enrichment under Georgia law based on operator's retaining of owner's cryptocurrency. Fed. R. Civ. P. 56(c).

[12] **Implied and Constructive Contracts** Unjust enrichment

Under Georgia law, the theory of unjust enrichment applies when there is no legal contract and when there has been a benefit conferred which would result in an unjust enrichment unless compensated.

[13] **Implied and Constructive Contracts** Effect of Express Contract

Under Georgia law, a party can only recover for a claim of unjust enrichment if there is not an express contract that governs the dispute.

[14] **Fraud** Questions for Jury

Summary Judgment Fraud and misrepresentation

Genuine issue of material fact as to whether owner of cryptocurrency was given or assented to agreement in which operator of cryptocurrency exchange disclaimed any warranties as to its exchange and reserved the right to change transaction limits precluded summary judgment in favor of operator as to owner's claims for fraudulent and negligent misrepresentation under Georgia law, alleging owner's inability to withdraw its cryptocurrency. Fed. R. Civ. P. 56(c).

Attorneys and Law Firms

***1130** John Joseph Richard, Mark B. Carter, Taylor English Duma LLP, Atlanta, GA, Martin Mushkin, Law Office of Martin Mushkin, LLC, Stanford, CT, for Plaintiffs.

Pratt H. Davis, Robert Daniel Terry, Parker MacIntyre, Atlanta, GA, for Defendants.

ORDER

AMY TOTENBERG, UNITED STATES DISTRICT JUDGE

This matter is before the Court on Defendants Bulbul Investments LLC d/b/a CampBX ("CampBX") and Keyur Mithwala's (collectively, "Defendants") [1] Motion for Summary Judgment [Doc. 75]. Plaintiff BDI Capital, LLC has also filed a Motion to Strike, which contains an embedded request for leave to file a sur-reply. [Doc. 83]. The Motion to Strike is **DENIED**, but the request to file the sur-reply is **GRANTED**, and the Court will direct the clerk to file the proposed sur-reply, Doc. 83-1, Pages 9–14. For the reasons that follow, the Motion for Summary Judgment is **GRANTED IN PART** and **DENIED IN PART**.

I. STANDARD FOR SUMMARY JUDGMENT

Summary judgment may only be granted when "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to summary judgment as a matter of law." FED. R. CIV. P. 56(c). The "purpose of summary judgment is to pierce the pleadings and to assess the proof

in order to see whether there is a genuine need for trial." *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986) (quoting the Advisory Committee's note to FED. R. CIV. P. 56). "[The] party seeking summary judgment always bears the initial responsibility of informing the district court of the basis for its motion, and identifying those portions of the [record before the court] which it believes demonstrate the absence of a genuine issue of material fact." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). The burden then shifts to the non-movant to establish, by going beyond the pleadings, that there is indeed a genuine issue as to the material facts its case. *Thompson v. Metro. Multi–List, Inc.*, 934 F.2d 1566, 1583 n.16 (11th Cir. 1991); *Chanel, Inc. v. Italian Activewear of Fla., Inc.*, 931 F.2d 1472, 1477 (11th Cir. 1991). A dispute of material fact "is 'genuine' ... [only] if the evidence is such that a reasonable jury could return a verdict for the non-moving party." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986); *see also* *Matsushita*, 475 U.S. at 587, 106 S.Ct. 1348.

When ruling on the motion, the Court must view all the evidence in the record in the light most favorable to the non-moving party and resolve all factual disputes in ***1131** the non-moving party's favor. *Welch v. Celotex Corp.*, 951 F.2d 1235, 1237 (11th Cir. 1992); *Ryder Int'l Corp. v. First Am. Nat'l Bank*, 943 F.2d 1521, 1523 (11th Cir. 1991). The Court must avoid weighing conflicting evidence. *Liberty Lobby*, 477 U.S. at 255, 106 S.Ct. 2505; *McKenzie v. Davenport–Harris Funeral Home*, 834 F.2d 930, 934 (11th Cir. 1987). Nevertheless, the non-moving party's response to the motion for summary judgment must consist of more than conclusory allegations, and a mere "scintilla" of evidence will not suffice. *Walker v. Darby*, 911 F.2d 1573, 1577 (11th Cir. 1990); *Peppers v. Coates*, 887 F.2d 1493, 1498 (11th Cir. 1989). But where a reasonable fact finder may "draw more than one inference from the facts, and that inference creates a genuine issue of material fact, then the court should refuse to grant summary judgment." *Barfield v. Brierton*, 883 F.2d 923, 933–34 (11th Cir. 1989) (citation omitted).

The essential question is "whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Anderson*, 477 U.S. at 251–52, 106 S.Ct. 2505.

II. FACTUAL BACKGROUND [2]

In 2011 Defendant Keyur Mithawala began, through his company CampBX, to develop the code for a Bitcoin trading platform that would allow its users to buy and sell Bitcoins against U.S. Dollars. (Def.'s Statement of Undisputed Material Facts ("SUMF") ¶ 6, *not disputed*, Pl.'s Resp. to SUMF ("RSUMF") ¶ 6).

Bitcoins [3] are a type of virtual currency, or "cryptocurrency" stored in virtual "wallets." (*Id.* ¶ 1). [4] A wallet, which is created by the official Bitcoin software, can store bitcoins of a single user. (*Id.* ¶ 2). Alternatively, a wallet can store bitcoins of multiple users using built-in "Accounts" functionality and track each user's Bitcoin balance independently, which is the type of "wallet" employed by CampBX. (*Id.* ¶ 2–3). Each account on the CampBX trading platform had two types of balances - Bitcoin and cash (in U.S. Dollars) (*Id.* ¶ 7).

Transferring bitcoins entails two "keys," a public key and a private key. "Both are ***1132** large strings of numbers that are mathematically linked to the wallet address.... The private key is used to mathematically derive the public key, which is transformed with a hash function to produce the address that other people can see." [5] Any bitcoin transfer thus creates a transaction ID (TXID), and in the case of a single user wallet as described above, the TXID of outgoing transfers includes a reference to one or more incoming TXID's. (*Id.* ¶ 4). In the case of a multi-user wallet, the TXID's of individual users may be jumbled due to the pooled nature of the wallet. (*Id.* ¶ 5).

In 2013, BDI, through Jay Daniel, began the process to set up an account with CampBX. (*Id.* ¶ 9). There were no transactions, attempted transactions or communications between BDI Capital, LLC ("BDI") and CampBX between May 2015 and July 2017. (*Id.* ¶ 10).

[1] Somewhere around July 4, 2017, Mr. Daniel alleges that he attempted to make a withdrawal of all of BDI's bitcoins stored on CampBX. (Deposition of Jay Daniel, at 40–42, Doc. 42). Mr. Daniel contends that he was unable to complete the transaction, and received an error message. (*Id.* at 43:17–22). He contends that he attempted to initiate a help desk ticket, but received a "red error message." (*Id.* at 47:11–17). Mr. Daniel

alleges he tried to make a help desk ticket again the next day, and received another error. (*Id.* at 49:12–20). Around that time, Mr. Daniel alleges he sent an email to CampBX, but received no response. (*Id.* at 50:18–20). Mr. Daniel does not have any record of these attempts and no longer has access to the email address from which this email was allegedly sent. (*Id.* at 27:5–27:16, 28:09–28:19, 52:11–20). Camp BX contends that it has full help desk records preserved from 2011 through the present, and there is no record of any help desk tickets being attempted or submitted by BDI in or around July 2017. (K. Mithawala Decl. ¶ 10, Doc. 75-3). [6]

Mr. Daniel made no further attempts to withdraw the coins until December of 2017. (Dep. Daniel at 53:17–21, 54:9–12, 17–20). Mr. Daniel contends that he received the same error message when he attempted to withdraw the Bitcoin, ostensibly regarding withdrawal limits, and the same error message when he attempted to make a help desk request. (*Id.* at 55). Mr. Daniel has no record of these attempts. (*Id.* at 56:1–4). Defendants likewise have no record of an email or alleged attempted second transaction in July of 2017. (K. Mithawala Decl. ¶ 11). Furthermore, the computer from which all of these transactions originated was destroyed. (Dep. Daniel at 49:2–49:6).

In December of 2017, Mr. Daniel contends that after reading a post on Reddit, he became aware that CampBX was in the process of shutting down or had been shut down, and at this point contacted BDI's ***1133** counsel. (*Id.* at 57:14–20, 58:2–22). The Court picks back up on this thread later.

Meanwhile, Defendants contend that in 2017, they decided to close CampBX because the banks it used had elected to discontinue their business with entities involved with virtual currencies such as Bitcoins. (K. Mithawala Decl. ¶ 13; Dep. K. Mithawala at 150:17-150:24). [7] The Reddit post referenced above was not posted by any of the Defendants. (Def.'s SUMF ¶ 20, *not disputed*, Pl.'s RSUMF ¶ 20). Defendants contend that they began to notify account holders in a staggered manner to withdraw their coins, ostensibly "to try to prevent an overwhelming number of questions to CampBX's help desk at one time." (K. Mithawala Decl. ¶ 14; Dep. K. Mithawala at 125:14-125:21). There appears to be no dispute that BDI never received such notice, though Defendants contend that this is because BDI was not in the first batch of account holders to be notified. (K. Mithawala Decl. ¶ 16; Daniel Decl. ¶ 13).

As noted above, BDI contacted its counsel in December of 2017, who sent a demand letter to Defendants dated December 6, 2017. (Am. Compl. ¶ 19, Ex. 2, Doc. 11-1 at 8; Answer ¶ 19 ("Defendants [sic] believes it received the letter referenced in the allegations of Paragraph 19 of the Complaint.")). The letter indicated that it was sent on behalf of Jay Daniel, not BDI, and provided an email address for Mr. Daniel directly. (Doc. 11-1 at 8). The letter stated that "our client is having trouble withdrawing bitcoins from the CampBX account from your company" and that "he has 14.86155791 BTC in their [sic] trading account along with ... $2,816.87." (*Id.*). The letter requested that CampBX "transfer these amounts immediately."

Defendant Keyur Mithawala did not receive the letter until approximately January 10, 2018. (Def.'s SUMF ¶ 27, *not disputed*, Pl.'s RSUMF ¶ 27). Defendants did not respond to the letter. (*Id.* ¶ 28). Defendants claim that they did not respond to it because it did not contain a valid CampBX user name or email address, making it impossible to identify the account to which it corresponded, and that the email and user name in the letter were not the same as the ones used to register the account. (*Id.* ¶¶ 28–29). Defendants claim that at the time, CampBX was receiving a large number of fraudulent requests for account takeovers and CampBX did not respond to anyone who did not provide the correct account information. (K. Mithawala Decl. ¶ 20). BDI argues in response that by contacting the lawyer who sent the letter, Defendants could have quickly determined the information necessary to identify the subject account. (Daniel Decl. ¶ 9).

In any case, BDI's counsel located and sent another letter dated January 9, 2018 to all additional addresses it could find for Defendants, (Daniel Decl. ¶ 10) but it was returned as not deliverable. (K. Mithawala Decl. ¶ 22; Def.'s SUMF ¶ 32, *not disputed*, Pl.'s RSUMF ¶ 32).

BDI filed this lawsuit on July 16, 2018, along with an Emergency Motion for Preliminary Injunction. (Compl., Doc. 1; Mot. Prelim. Inj., Doc. 4). Defendants Bulbul and Keyur Mithawala were served on July 25, 2018. (Docs. 17–18). After CampBX was served with the lawsuit, and thus allegedly first became aware of BDI's desire to retrieve its Bitcoins, it requested certain authentication information including a tax identification number from BDI before it would return BDI's Bitcoins. (K. Mithawala ***1134** Decl. ¶ 23). BDI disputes that this information was necessary given that BDI contends it had already provided this identifying information. (Daniel Decl. ¶ 4).

Through their Answer, filed on August 15, 2018, Defendants admitted that CampBX was in possession of $2,816.87 in cash and 14.86155791 Bitcoin belonging to BDI. (Am. Compl. ¶ 22, Doc. 11, *admitted*, Answer ¶ 22, Doc. 21). On November 26, 2018, the Parties entered into a Consent Order on BDI's Motion for Preliminary Injunction. (Doc. 48). The Consent Order recites that the Parties met on September 26, 2018, at which point CampBX returned $2,816.87 in cash and 14.84109000 Bitcoin to BDI. [8]

Despite the return of the Bitcoin, BDI has contended throughout this lawsuit that CampBX is unlawfully retaining Bitcoin "forks." (Doc. 48 at 4). The Court addresses this contention further in the section on BDI's conversion claim, below.

III. ANALYSIS

BDI asserts that Defendants are liable to it, over and above the value of the returned Bitcoin, under the federal Commodities Exchange Act, as well as based on several state law claims. The Court addresses each in turn.

A. Commodities Exchange Act

[2] "The Commodity Exchange Act (the 'CEA'), 7 U.S.C. §§ 1–25, regulates those who participate in transactions involving commodities futures." *Scott v. Prudential Sec., Inc.*, 141 F.3d 1007, 1013 n.10 (11th Cir. 1998), *abrogated by* *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 128 S.Ct. 1396, 170 L.Ed.2d 254 (2008). [9] For the purpose of the present motion, the Court assumes that Bitcoin is a "commodity" under the Act, as no party appears to dispute this. *See* *CFTC v. McDonnell*, 287 F. Supp. 3d 213, 217 (E.D.N.Y. 2018) ("A 'commodity' encompasses virtual currency both in economic function and in the language of the statute.").

The Parties agree that to bring a private right of action under the CEA, a plaintiff must fit into one of the categories set forth in 7 U.S.C. § 25:

> **(a) Actual damages; actionable transactions; exclusive remedy**
>
> (1) **Any person** (other than a registered entity or registered futures association) **who violates this chapter** or who willfully aids, abets, counsels, induces, or procures the commission of a violation of this chapter **shall be liable for actual damages resulting from one or more of the transactions referred to in subparagraphs (A) through (D)** of this paragraph and caused by such violation to **any other person**—
>
> (A) who received trading advice from such person for a fee;
>
> (B) who made through such person any **contract of sale of any commodity for future delivery** (or option on such contract or any commodity) or any swap; or who deposited with or paid to such person money, securities, ***1135** or property (or incurred debt in lieu thereof) in connection with any order to make such contract or any swap;
>
> **(C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of**—
>
> (i) an option subject to section 6c of this title (other than an option purchased or sold on a registered entity or other board of trade);
>
> (ii) a **contract subject to section 23** of this title; or
>
> (iii) an interest or participation in a commodity pool; or
>
> (iv) a swap; or
>
> (D) **who purchased or sold a contract referred to in subparagraph (B)** hereof or swap if the violation constitutes—
>
> (i) the use or employment of, or an attempt to use or employ, in connection with a swap, or a contract of sale of a commodity, in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative device or contrivance in contravention of such rules and regulations as the Commission shall promulgate by not later than 1 year after July 21, 2010; or
>
> (ii) a manipulation of the price of any such contract or swap or the price of the commodity underlying such contract or swap.

7 U.S.C. § 25 (emphasis added).

[3] There is no dispute that Subparagraph (A) does not apply to this case, as Defendants provided no trading advice for a fee. And courts have held that a "condition precedent" to a Subparagraph (D) claim is that "the plaintiff purchased or sold a contract for future delivery." *In re Dairy Farmers of Am., Inc., Cheese Antitrust Litig.*, 60 F. Supp. 3d 914, 965–66 (N.D. Ill. 2014), *aff'd*, 801 F.3d 758 (7th Cir. 2015) (citing See *Thompson's Gas & Elec. Serv., Inc. v. BP Am. Inc.*, 691 F.Supp.2d 860, 871 (N.D. Ill. 2010); *In re Soybean Futures Litig.*, 892 F. Supp. 1025, 1041 (N.D. Ill. 1995)). As such, cash or "spot" purchasers of physical commodities do not have a claim under that section. *Id.* at 965–66 ("Purchasers of physical commodities whose prices were affected by futures trading do not have a claim.").

The same logic — that only "futures contracts" are covered by Section 25 — would logically apply to a Subparagraph (B) claim, as Subparagraph (D) expressly incorporates Subparagraph (B). That is exactly what was held in *Berk v. Coinbase, Inc.*, No. 18-CV-01364-VC, 2018 WL 5292244, at *2 (N.D. Cal. Oct. 23, 2018) ("[Plaintiff] has a private right of action under the CEA only if he used [Defendant] to make a "contract of sale of [a] commodity for future delivery" – in other words, a "futures contract."). *Berk* is particularly on point, as the court in that case dismissed with prejudice a claim arising from the purchase of Bitcoin Cash because the plaintiff used the defendant "to purchase Bitcoin Cash, rather than to make a contract to purchase Bitcoin Cash at a specific date in the future." *Id.* Defendants contend that this Court should follow *Berk* and dismiss BDI's claims under the CEA because BDI seeks damages arising from the spot sale of a commodity. The Court agrees.

In a last ditch effort to save its claims, BDI asserts that it may bring a claim under Subparagraph C against a person ***1136** "who purchased from or sold to such person [who violated the CEA] or placed through such person an order for the purchase or sale of ... a contract subject to section 23" of the CEA. (Resp. at 5–6 (citing 7 U.S.C. § 25(a)(1)(C)(ii))). BDI contends that because it "purchased Bitcoin through a contract for a commodity as described in Section 23(a) of the CEA, ... [it therefore] has a private right of action" under Subparagraph (C). (*Id.* at 6). As you might expect, this cross-reference portends another block quote. Section 23(a) of the CEA prohibits a transaction for the delivery of commodities under a "margin account, margin contract, leverage account, or leverage contract," or any similar arrangement as determined by the Commodities Futures Trading Commission, except as provided in Section 23(b):

> (b) Permission to enter into contracts for delivery of **silver or gold bullion, bulk silver or gold coins, or platinum**; rules and regulations.
>
> (1) Subject to paragraph (2), no person shall offer to enter into, enter into, or confirm the execution of, any transaction for the delivery of **silver bullion, gold bullion, bulk silver coins, bulk gold coins, or platinum under a standardized contract described in subsection (a)**, contrary to the terms of any rule, regulation, or order that the Commission shall prescribe, which may include terms designed to ensure the financial solvency of the transaction or prevent manipulation or fraud. Such rule, regulation, or order may be made only after notice and opportunity for hearing. The Commission may set different terms and conditions for transactions involving different commodities.
>
> (2) No person may engage in any activity described in paragraph (1) who is not permitted to engage in such activity, by the rules, regulations, and orders of the Commission in effect on the date of the enactment of the Futures Trading Act of 1986 [enacted Nov. 10, 1986], until the Commission permits such person to engage in such activity in accordance with regulations issued in accordance with subsection (c)(2).

7 U.S.C. § 23(b). Defendants correctly argue that this section, which deals with unregulated margin accounts [10] and leverage contracts [11] for commodities (specifically gold, silver, and platinum), is inapplicable to this case. [12] Accordingly, Defendants are entitled to summary judgment on this claim. [13]

B. Conversion

[4] **[5]** BDI next argues that Defendants should be held liable for conversion ***1137** of its bitcoins by failing to return them upon demand. As no court in Georgia has addressed the issue, an initial question is whether bitcoins, as virtual, intangible cryptocurrency, may be the subject of a conversion action at all. Several potential analogues exist. For example. "[c]onversion is not available as a cause of action with respect to intangible property representing an interest in a business. *S. Cellular Telecom, Inc. v. Banks*, 208

Ga.App. 286, 431 S.E.2d 115, 120 (1993) (citing *Hodgskin v. Markatron*, 185 Ga.App. 750, 365 S.E.2d 494 (1988)). However, "specific intangible property may be the subject for an action for conversion, but as fungible intangible personal property, money, generally, is not subject to a civil action for ... conversion." *Taylor v. Powertel, Inc.*, 250 Ga.App. 356, 551 S.E.2d 765, 769 (2001) (citing *Jennette v. Nat. Community Dev. Svcs.*, 239 Ga.App. 221, 520 S.E.2d 231 (1999); *William Goldberg & Co. v. Cohen*, 219 Ga.App. 628, 466 S.E.2d 872 (1995); *Jones v. Turner Broadcasting System*, 193 Ga.App. 768, 389 S.E.2d 9 (1989)).

[6] *Kleiman v. Wright*, No. 18-CV-80176, 2018 WL 6812914, 2018 U.S. Dist. LEXIS 216417 (S.D. Fla. Dec. 27, 2018) addressed whether bitcoins were "money" and thus incapable of being the subject of a conversion action under Florida law. The Court held that bitcoins could be the subject of a conversion action, because in "regards to the bitcoin's specificity and identity, Plaintiffs have alleged that the bitcoin blockchain is a giant ledger that tracks the ownership and transfer of every bitcoin in existence and that every bitcoin wallet and the number of bitcoin inside that particular wallet can be identified on the blockchain by referring to its public key." *Id.*, 2018 WL 6812914, at *15–16 (internal quotations omitted). The Court agrees with *Kleiman* that bitcoins are sufficiently identifiable to be considered "specific intangible property" subject to an action for conversion. The next question is whether a conversion claim is applicable to this set of facts.

[7] **[8]** As explained above, BDI's bitcoin purchases through CampBX were cash sales, as opposed to margin sales. Under Georgia law governing stockbrokers, "[a] cash customer, as distinguished from one who has purchased stock on margin, is entitled to the delivery of stock purchased for him, and in the absence of an agreement or instructions to the contrary, the broker undertakes and agrees to deliver the stock to the customer either immediately or in such time as is necessary to effectuate the transfer and is reasonable under the circumstances ... If a broker refuses to make delivery upon demand ... he is liable for conversion." *Drexel Burnham Lambert, Inc. v. Chapman*, 174 Ga.App. 336, 329 S.E.2d 595, 600 (1985) (quoting *E.F. Hutton & Co. v. Weeks*, 166 Ga.App. 443, 304 S.E.2d 420 (1983) (internal quotations omitted)). The Georgia appellate courts would likely extend the logic of *Drexel Burnham Lambert* to Bitcoin in this circumstance. As such, a claim for conversion exists, and several genuine, material disputes of fact exist, such as: (1) whether or when the demands for possession were made; (2) Defendants' intent; (3) whether Defendant's explanation for failing to respond promptly to the letter sent by Plaintiff's counsel on December 6, 2017 is a factually ***1138** and legally justifiable defense; and, (4) as noted in the section on unjust enrichment below, whether the purported CampBX Terms of Service apply to this case and if so, whether they limit Plaintiff's damages.

Bitcoin Forks

As noted above, BDI has contended throughout this lawsuit that CampBX is unlawfully retaining Bitcoin "forked currency" which occurred "within the period during which CampBX admits to having possession of BDI's 14.86155791 Bitcoin" (Doc. 48 at 3). Specifically:

> On August 1, 2017, Bitcoin forked at block 478558 (in the Blockchain) resulting in the creation of Bitcoin Cash. For each Bitcoin held on that date, an equal number of Bitcoin Cash was created which BDI contends became tied or linked to the respective Bitcoin owner's wallet;
>
> On October 24, 2017, Bitcoin forked at block 491407 (in the Blockchain) resulting in the creation of Bitcoin Gold. For each Bitcoin held on that date, an equal number of Bitcoin Gold was created which BDI contends became tied or linked to the respective Bitcoin owner's wallet; and
>
> On February 18, 2018, Bitcoin forked at block 511346 (in the Blockchain) resulting in the creation of Bitcoin Private. For each Bitcoin held on that date, an equal number of Bitcoin Private was created which BDI contends became tied or linked to the respective Bitcoin owner's wallet.

(Doc. 3 at 4–5). Pending the resolution of this suit, Plaintiff counsel is holding $8,128.98 representing the value of these "forked currencies" as of November 12, 2018.

A bitcoin "fork" is the creation of a new virtual currency based on the blockchain ledger of an existing virtual currency. *Kleiman* contains a discussion on Bitcoin forks (based on allegations made in that plaintiff's complaint):

> Since its beginning, Bitcoin has inspired the creation of over one thousand other digital currencies.

> These new currencies often borrow from the initial Bitcoin program but make changes to the model in an attempt to create a new cryptocurrency with distinct functions or more suited to a specific market or niche. In other cases, Bitcoin has been modified by individuals in a way they believed would improve the Bitcoin itself, such as by allowing more transactions into a single block of blockchain. In these situations, the supporters of the new Bitcoin, have created a "fork" through which the original Bitcoin blockchain/ ledger is divided into two distinct, but identical, copies, (i) the original Bitcoin, and (ii) the new Bitcoin. The result is that any individual who owned the original Bitcoin now owns an identical amount of the new Bitcoin.

 *Kleiman*, No. 18-CV-80176, 2018 WL 6812914, at *2 (citations omitted).

A bitcoin exchange's duties with respect to a bitcoin fork presents a case of first impression in the truest sense of the word. [14] Commentators have struggled to place bitcoin forks into an existing legal framework. For example, "[i]t has been ***1139** suggested, and disputed, that the hard fork represents a scenario similar to a stock split[,] ... like a two-for-one stock split, a unit was doubled by the hard fork; holders of Bitcoin received an equal amount of [forked currency] Bitcoin Cash." Nick Webb, Comment, *A Fork in the Blockchain: Income Tax and the Bitcoin/bitcoin Cash Hard Fork*, 19 N.C.J.L. & Tech. On. 283, 299 (2018) (footnotes omitted). However, "the divergence of the network and the creation of two entirely separate blockchains do not sound like a stock split. Stock splits do not result in the construction of an entirely separate entity." *Id.* at 299–300.

Forked currency does not simply appear in a bitcoin wallet. [15] To access the forked coins, the holder of the bitcoins must download software which supports the forked currency. [16] Accordingly, commenters have noted an important distinction between bitcoin owners who hold the coins in their own private wallets and those who hold their bitcoins on an exchange (as BDI did in this case). Writing in the context of when forked currency constitutes taxable gain, one commentator wrote:

> Investors who own private keys to their digital wallets have likely constructively received the forked coins at the time of the hard fork because they only need to download a new software that is compatible with the forked coins to receive them... However, many third-party exchanges take no action to claim the forked coins until the security risks have been evaluated and mitigated. Since these investors' receipt of forked coins is subject to substantial limitations, that is, the third-party exchange's decision to download the software and support the forked coins, their accession to wealth is not "clearly realized" at the time of the hard fork.

Danhui Xu, Comment, *Free Money, but Not Tax-Free: A Proposal for the Tax Treatment of Cryptocurrency Hard Forks*, 87 Fordham L. Rev. 2693, 2701 (2019) (footnotes omitted).

Forks can happen for numerous reasons. [17] "Because the software that runs the ledger generally is open-source, and the network of computers that verify transactions generally operates via consensus, the ***1140** software can be modified if enough participants on the network agree to do so." [18] This open-source nature has resulted in all kinds of forks. [19]

As noted above, in order for a bitcoin owner who holds her virtual currency in an exchange (or other type of shared wallet) to access the forked currency, the exchange must take some affirmative action. The Court would be imposing a major new duty on all cryptocurrency exchanges operating in Georgia to affirmatively honor every single bitcoin fork. Bitcoin investors are aware they are operating in an unregulated market, and therefore it seems more reasonable to place the burden to ensure access to forked currency on the investors themselves. There is no requirement that investors keep their coins in exchanges; they can always withdraw the coins to their own private wallets. [20] In the unregulated

cryptocurrency market, potential investors are well advised to ensure that the terms of service of the exchange they are using clearly spell out what the exchange's obligations are with respect to forked cryptocurrency, if any.

[9] Even if Defendants were not required to support the currency forks, BDI implies that Defendants should have warned its users about the impending fork. In Mr. Daniel's declaration, he states that "exchanges or trading platforms provide notices sufficiently in advance of the date of individual forks, that the trading platform or exchange will not be making a specific forked currency available so that the customer could withdraw Bitcoin to the customer's own wallet to take advantage of a particular fork." (Daniel Decl. ¶ 21). BDI points to no Georgia law on point that would require such notice.

Under Georgia law, a stockbroker is under no duty to advise clients of a pending stock split or dividend before processing a sale order. *Drexel Burnham Lambert, Inc. v. Chapman*, 174 Ga. App. 336, 339, 329 S.E.2d 595, 599 (1985) (holding that there is not "any legal support" for a duty of a stockbroker to advise clients that "when they ordered sales, that the result would be that they would not be entitled to the dividend stocks."). The Court assumes that the Georgia appellate courts would extend this logic to the context of Bitcoin forks. Accordingly, the Court holds that Defendants were not under any affirmative obligation to warn BDI in advance that it ***1141** would not be supporting forked cryptocurrency.

[10] This holding does not mean that cryptocurrency forks are ripe for theft. If an exchange, trading platform, or other shared wallet affirmatively undertakes to support forked currency, they have voluntarily assumed the obligation of holding these coin forks for their respective owners. At this point, they must account for the forked currencies upon demand by their rightful owner. However, BDI has not submitted any evidence that CampBX at any point undertook to support the forked currency at issue. The only evidence BDI provides in opposition to Defendants' summary judgment motion is Mr. Daniel's declaration, which in turn simply states that "[t]he dates of the respective forks are all within the period during which CampBX admits to having possession of BDI's 14.86155791 Bitcoin." (Daniel Decl. ¶ 18). This is not sufficient circumstantial evidence to create an inference that CampBX voluntarily undertook to support the forked currency during that period. In fact, Mr. Daniel's declaration goes on to state that

> "[n]one of the information available on the CampBX website made any mention of Defendant's current position that they would attempt to retain the forked currencies as they [sic] own, that they would restrict access to the forked currencies, or would prevent customers such as BDI from extracting those forked currencies themselves as property born from the Bitcoin held in BDI's account."

(*Id.* ¶ 19). Mr. Daniel makes several allegations about CampBX's public statements but does not allege that it ever made any statement that it would voluntarily undertake to support the forked currency at issue. Accordingly, there is no genuine, material factual dispute as to this issue, and Defendants are entitled to summary judgment on BDI's conversion claim as to the forked cryptocurrency. [21] Plaintiff may continue to hold the $8,128.98 representing the value of the forked currency pending final judgment of this case and termination of all rights of appeal. However, in the event that the Court's ruling that Defendant is not liable for conversion of the forked currency becomes final, the Court will award Defendants interest on the $8,128.98 at the judgment rate from the date of entry of this Order, unless the $8,128.98 is returned to Defendants within fourteen days of the date of entry of this order.

C. Unjust Enrichment

[11] The Court next turns to BDI's claim for unjust enrichment. Defendants claim that "the only benefit that CampBX received from the BDI account was the $614.00 in trading fees that it collected as ***1142** a result of BDI's trades." (K. Mithawala Decl. ¶ 36). BDI alleges that "[b]y delaying the return of BDI's Bitcoin, and in fact substituting different Bitcoin acquired at a much lower value, Defendants were able to enjoy the use of BDI's higher value Bitcoin for their own purposes while at the same time depriving BDI of the use of benefit of own property." (Resp. at 13, citing Daniel Decl. ¶ 23). To the extent that BDI seeks the difference in value between the Bitcoin at the time of demand and at the time of return, this essentially duplicates the measure of damages of the conversion claim, which the Court has held is not subject to summary judgment except as to the forked currency. To the extent that BDI contends that CampBX used the bitcoins to profit in the marketplace before returning them, there is a factual dispute about whether CampBX received any such benefit above and beyond the $614 in trading fees.

[12] **[13]** Furthermore, under Georgia law, " '[t]he theory of unjust enrichment applies when there is no legal contract and

when there has been a benefit conferred which would result in an unjust enrichment unless compensated.' " *Clark v. Aaron's, Inc.*, 914 F.Supp.2d 1301, 1309 (N.D. Ga. 2012) (quoting *Smith Serv. Oil Co. v. Parker*, 250 Ga.App. 270, 549 S.E.2d 485, 487 (2001)). A party can only recover for a claim of unjust enrichment if there is not an express contract that governs the dispute. *See Fed. Ins. Co. v. Westside Supply Co.*, 264 Ga.App. 240, 590 S.E.2d 224, 232 (2003) ("Recovery under [the theory of unjust enrichment] presupposes the absence of a contractual agreement.").

Defendants attached the purported CampBX User Agreement ("Agreement") as Exhibit 8 to the Motion for Summary Judgment. (Doc. 75-10). The Agreement states that "CampBX makes no assurances or warranties about the value, performance, or integrity of Bitcoins or the CampBX platform" (Agreement ¶ 3) and that "CampBX accepts no responsibility for the accurate maintenance of the trading platform, information, calculation, or valuation. The Client bears the entire risk of loss, including, but not limited, for data, calculation, and valuation of Bitcoins and Bitcoin transactions." (*Id.* ¶ 8). The Agreement also purports to limit CampBX's liability to "one month's charges to client by CampBX." (*Id.* ¶ 13).

There is a factual dispute in this case about whether the terms of service apply as between the parties. (Pl.'s RSUMF ¶ 17 ("Disputed. The CampBX User Agreement advanced by Defendants does not apply as no User Agreement or 'terms of service' was ever presented to BDI when BDI opened its account with CampBX or later used the CampBX site ....", citing Daniel Decl. ¶¶ 5, 21; Dep. Daniel. 72:16-74:14). Accordingly, Defendants are not entitled to summary judgment on this claim.

D. Fraudulent and Negligent Misrepresentation

[14] Counts 3 and 4 of the Amended Complaint are for fraudulent and negligent misrepresentation respectively. (Am. Compl. ¶¶ 56–62). The counts do not contain specific instances of misrepresentations, but rather incorporate by reference preceding allegations. (*Id.*). In response to Defendant's motion for summary judgment, BDI states that it has "set forth sufficient admissible evidence showing representations made by Defendants that later proved to be incorrect to create issues of fact for determination by a jury." (Resp. at 12, citing Daniel Decl. ¶ 6.) BDI does not otherwise indicate anywhere in the record where such representations exist.

***1143** Defendant's Statement of Material Facts contains two statements of fact arguably on point. Number 36 states, "[n]one of the Defendants ever tried to mislead the Defendants."[22] (Def.'s SUMF ¶ 36, citing K. Mithawala Decl. ¶ 25). In denying this statement, BDI states, "[f]or instance, Defendant misled BDI regarding KYC compliance and access to withdrawals, and as to whether forked currencies attributable to BDI's Bitcoin would be available to BDI." (Pl.'s RSUMF ¶ 38, citing Daniel Decl. ¶¶ 6, 14–25). Number 38 states that "[n]either K. Mithawala nor CampBX ever spoke to anyone at BDI before it began using the CampBX platform." (Pl.'s SUMF ¶ 38, citing K. Mithawala Decl. ¶ 27). In response, BDI states, "[n]ot disputed though also not alleged as a basis for the written representations made by CampBX on its website regarding the availability of Bitcoin withdrawals that turned out to be false." (Pl.'s RSUMF ¶ 38, citing Daniel Decl. ¶ 6).

As paragraphs 14–24 of the Daniel Declaration concern Bitcoin forks, of which the Court has held Defendants were under no obligation to inform BDI, the sole piece of evidence that BDI submits in response to summary judgment on its misrepresentation claims is paragraph 6 of the Daniel Declaration, set forth below:

> At the time BDI established its account with CampBX, the statements made by CampBX on its website were to the effect that it would provide a stable and reliable exchange platform without the limits on withdrawals or trading activity that CampBX later imposed. For instance, KYC [Know Your Customer] compliance was not required for transactions under $1000.00. After BDI completed its KYC requirements in December 2013, BDI was supposed to be able to perform transactions between $1000.00 and $5,000.00 per day. BDI reasonably relied on CampBX's statements to this effect, and as referenced in BDI's Verified Complaint, when making the decision to open and maintain its account with Defendants. Beginning in July 2017, CampBX was unilaterally and

> without explanation limiting BDI's transactions at all levels despite BDI's KYC approval.

(Daniel Decl. ¶ 6).

The proffered CampBX Agreement contains several provisions in tension with these supposed misrepresentations. For example, Paragraph 3 states, "CampBX makes no assurances or warranties about the value, performance, or integrity of Bitcoins or the CampBX platform." (Agreement ¶ 3, Doc. 75-10). Paragraph 6 states, "CampBX reserves the right, in its sole discretion, to at any time, change any transaction limit and or policy." (*Id.* ¶ 6). Paragraph 8 states that "CampBX accepts no responsibility for the accurate maintenance of the trading platform, information, calculation, or valuation." (*Id.* ¶ 8). Paragraph 13 states, "[t]o the extent permitted by applicable law, the CampBX trading platform and any and all CampBX services are provided "as is" and without express or implied warranty of any kind .... No covenants, warranties, representations, or indemnities of any kind are provided to client or any end user." (*Id.* ¶ 13).

If the Agreement in fact is binding in this case, reliance on the supposed misrepresentations provided in Mr. Daniel's declaration are precluded by the Agreement's express terms. However, as the Court has held that a fact dispute exists over whether ***1144** this agreement was in fact presented to and agreed to by BDI when its account was created, the Court will deny summary judgment on this Count.

E. Attorney's Fees

BDI seeks attorney's fees under O.C.G.A. § 13-6-11. Because the Court has not entered summary judgment on all of BDI's claims, the issue of BDI's entitlement to attorney's fees is premature. Under that statute, entitlement to fees and expenses for bad faith is an issue for the jury. *Trade AM Int'l, Inc. v. Cincinnati Ins. Co.*, No. 1:08-CV-3711-ECS, 2012 WL 12957383, at *1 (N.D. Ga. Jan. 18, 2012).

IV. CONCLUSION

BDI is correct that, even though it lacks documentary evidence of its earlier attempts to withdraw its Bitcoin, Mr. Daniel's sworn statement that BDI made such attempts precludes summary judgment. *United States v. Stein*, 881 F.3d 853, 854 (11th Cir. 2018) (holding that "an affidavit which satisfies Rule 56 of the Federal Rules of Civil Procedure may create an issue of material fact and preclude summary judgment even if it is self-serving and uncorroborated."). It is not the Court's role to weigh evidence on summary judgment. However, before proceeding to trial, BDI should seriously consider how the loss of all records of its earlier attempts to withdraw the Bitcoin and the lack of any documentary evidence on Defendants' end will be received by a jury. On the other hand, Defendants should give serious thought to whether a jury will find Mr. Mithawala's justification for disregarding the letter from BDI's counsel credible. The Court is aware that the Parties were not able to successfully mediate this case before. (Doc. 67). It is in the interest of all Parties to try again.

Accordingly, Defendants' Motion for Summary Judgment [Doc. 75] is **GRANTED IN PART** and **DENIED IN PART**. Plaintiff's Motion to Strike [Doc. 83] is **DENIED**, but the embedded request to file the sur-reply is **GRANTED**. The Clerk is **DIRECTED** to file the proposed sur-reply (Doc. 83-1, Pages 9–14).

The Court **ORDERS** the parties to attend a second round of mediation to be completed within 40 days of the entry of this Order. The parties may use the same mediator they used before, or alternatively may request for the Court's appointment of a private mediator. The parties should notify the Court within seven (7) days of the date of entry of this Order if they request that the Court appoint a new private mediator. The parties are **DIRECTED** to file a status report within 5 days of the conclusion of the mediation indicating whether this matter is resolved.

If this case is not settled in mediation, the parties are **DIRECTED** to submit a consolidated pretrial order within 20 days of the filing of their status report. The Clerk is **DIRECTED** to submit this matter to the undersigned if there is no activity in this case within 70 days of the date of entry of this Order

IT IS SO ORDERED this 11th day of March, 2020.

All Citations

446 F.Supp.3d 1127

Footnotes

1 Plaintiff's claims against Defendant Priyam Mithawala were voluntarily dismissed without prejudice on August 8, 2019 (See Doc. 74).

2 Keeping in mind that when deciding a motion for summary judgment, the Court must view the evidence and all factual inferences in the light most favorable to the party opposing the motion, the Court provides the following statement of facts. *See* *Optimum Techs., Inc. v. Henkel Consumer Adhesives, Inc.*, 496 F.3d 1231, 1241 (11th Cir. 2007) (observing that, in connection with summary judgment, the court must review all facts and inferences in light most favorable to non-moving party). This statement does not represent actual findings of fact. *Priester v. City of Riviera Beach*, 208 F.3d 919, 925 n.3 (11th Cir. 2000) ("We ... have repeatedly stressed that the 'facts', as accepted at the summary judgment stage of the proceedings, may not be the 'actual' facts of the case."). Instead, the Court has provided the statement simply to place the Court's legal analysis in the context of this particular case or controversy.

3 For the purposes of the Order, generally speaking, "Bitcoin," in the capitalized singular refers to the cryptocurrency with the symbol BTC, while "bitcoin" or "bitcoins" refers more generally to cryptocurrency, inclusive of cryptocurrency modeled on Bitcoin.

4 It is also possible to store bitcoins in "hardware" wallets which must be physically accessible. *See* ABA Section of Taxation, Comment Letter on Tax Treatment of Cryptocurrency Hard Forks for Taxable Year 2017, at 4 (Mar. 19, 2018), https://www.americanbar.org/content /dam/aba/administrative/taxation/policy/031918comments2.authcheckdam.pdf.

5 ABA Section on Taxation, *supra* note 4.

6 BDI argues that it sought discovery of "all records regarding this issue and that Defendants intended to use to support any defenses" and that "[n]o such records were produced to show the absence of communications with BDI." (Pl.'s RSUMF ¶ 14). BDI contends that under Fed. R. Civ. P. 37(c)(1), the failure to produce this information precludes Defendants from offering evidence of it. BDI is mistaken. Rules 26(b)(1) and 34(b) do not require a party to produce all of its records to prove the absence of a record; the party need only state that a diligent search was performed and no such records were located. BDI's objection to Defendants' SUMF ¶¶ 16 & 25 are likewise overruled.

7 Defendants testified to additional reasons for closing the exchange, such as increasing regulatory burden. (Ex. 3, K. Mithawala Depo. 150:17-152:5)

8 The remaining 0.02046791 Bitcoin was assessed by the Bitcoin system as transaction charges. "As an accommodation," CampBX provided BDI a check for $126, representing the approximate value as of the time of the transfer of the other Bitcoins. (Doc. 48).

9 A helpful discussion of the mechanics of commodities futures trading is set forth in *Kohen v. Pac. Inv. Mgmt. Co. LLC*, 571 F.3d 672, 674 (7th Cir. 2009) (Posner, J.).

10 "A margin account is a device used to extend credit to investors who buy securities. Initially, the investor pays only a percentage of the purchase price, borrowing the difference from the brokerage firm. The purchased securities are themselves used as collateral for the loan. The arrangement is a dynamic one, however, because the value of stock fluctuates. If the market price of the securities decreases, the collateral's value

is diminished and the broker may demand that the investor deposit incremental funds." *Advest, Inc. v. McCarthy*, 914 F.2d 6, 7 (1st Cir. 1990).

11 A "leverage contract" means "a contract, standardized as to terms and conditions, for the long-term (ten years or longer) purchase ("long leverage contract") or sale ("short leverage contract") by a leverage customer of a leverage commodity," subject to certain other specified provisions. 17 C.F.R. § 31.4(w).

12 It goes without saying that "Bitcoin Gold" is not the equivalent of "gold bullion" or "bulk gold."

13 While this disposes of the only federal claim set forth in the Amended Complaint, BDI has also invoked this Court's diversity jurisdiction based on the complete diversity of the parties and the amount in controversy asserted due to the purported difference in value between when BDI's bitcoins were allegedly demanded and when they were returned.

14 It appears that lawsuits against exchanges arising from cryptocurrency forks have been filed in China and Japan. Kevin Helms, *Lawsuit Brewing Against Crypto Exchanges in Japan Over Withheld Forked Coins*, Bitcoin.com (June 1, 2018), https://news.bitcoin.com/lawsuit-crypto-exchanges-japan-withheld-forked-coins/; Stephen O'Neal, *Can Crypto Exchanges Be Trusted With Hard Forks?*, Cointelegraph.com (Aug. 9, 2019), https://cointelegraph.com/news/can-crypto-exchanges-be-trusted-with-hard-forks. As of the entry of this Order, the Court was unable to ascertain the outcome of these lawsuits, if any.

15 ABA Section on Taxation, *supra* note 4, at 4–5 ("When an owner holds a cryptocurrency wallet directly (rather than through a custodial wallet), the owner does not actually receive anything new in a Hard Fork. Instead, the owner — once he or she has taken the necessary steps (as described below) — is able to use the same private key to transact on each of the ledgers. If the owner uses his or her private key to transact in the original cryptocurrency, the network participants verifying transactions on the original ledger will add it to that ledger, but the network participants verifying transactions on the forked ledger will not recognize it."). In other words, after the fork, the same private key may be used to transact on the forked ledger without affecting the original ledger, and visa versa.

16 *Id.* at 5 ("An owner that holds the original coin in a basic wallet (whether hardware or software), generally must download new software to a computer to use the forked coin.").

17 "For example, one reason for Hard Forks is that users of the network agree that a fundamental upgrade to the ledger software is required. .... In contrast, some forks are a response to user mistrust in the original coin." ABA Section on Taxation, *supra* note 4 at 5.

18 ABA Section on Taxation, *supra* note 4 at 4.

19 Other examples include "bitcoin gold in October 2017, bitcoin diamond in November 2017, and superbitcoin, bitcoin hot, and lightning bitcoin in December 2017." *Id.* at 5 n.6. Programmers have also created strange and fanciful alternative cryptocurrency, known as "altcoins," such as Coinye West, which was not endorsed by Kanye West and led to litigation in the Southern District of New York. *See West et al v. 0Daycoins.com et al.*, No. 1:14-cv-00250-AT (S.D.N.Y. filed Jan. 14, 2014). Further examples abound: one altcoin, Dogecoin, sponsored a NASCAR driver. Wow. *Doge At 'Dega: Dogecoin Sponsors Race Car*, NPR Morning Edition, May 1, 2014, *available at* https://www.npr.org/sections/alltechconsidered/2014/05/01/308569803/doge-at-dega-dogecoin-sponsors-race-car; *see also* Kevin Roose, *Is There a Cryptocurrency Bubble? Just Ask Doge*, N.Y. Times, Sept. 16, 2017, at B1, *available at* https://www.nytimes.com/2017/ 09/15/business/cryptocurrency-bubble-doge.html.

20 ABA Section on Taxation, *supra* note 4, at 6 ("It is generally possible for an owner to transfer the original coin from one wallet that will not support a Hard Fork and into another wallet that will support the Hard Fork

prior to the occurrence of the Hard Fork. In that manner, the owner generally should be able to go through the processes necessary to claim the forked coin, at least if the owner is aware that a Hard Fork is going to occur.").

21 None of this is to say that the value of the cryptocurrency forks are not recoverable as compensatory damages for conversion of the Bitcoin. Under O.C.G.A. § 51-10-6, in an action for civil theft, a "property owner may recover compensatory damages which may include, in addition to the value of the personal property, any other loss sustained as a result of the willful damage or theft offense." If the jury finds that some or all of the forks occurred during a period of time where Defendants were willfully retaining the Bitcoin in the face of a valid demand for possession, it may determine that the value of the forked currency constitutes loss sustained as a result of the theft. *See* *Grant v. Newsome*, 201 Ga. App. 710, 711, 411 S.E.2d 796, 798 (1991) ("[C]onsequential damages, which are generally recoverable in tort actions under OCGA § 51-12-3(b), can also be recovered in a conversion action."). The Court will take up this issue closer to trial.

22 So in original. Should likely read Plaintiff.

TAB 40

Coinbase Inc. v. Bielski, 214 L. Ed. 2d 298, 143 S. Ct. 521 (2022) 2022 WL 3099846

December 9, 2022

143 S.Ct. 521
Supreme Court of the United States.

COINBASE INC., Petitioner,
v.
Abraham BIELSKI.

No. 22-105.
|

Case below, 2022 WL 3099846.

Opinion

Petition for writ of certiorari to the United States Court of Appeals for the Ninth Circuit granted.

All Citations

143 S.Ct. 521 (Mem), 214 L.Ed.2d 298

TAB 41

In re SVB Financial Group, Case No. 23-10367 (Bankr. S.D.N.Y.)

Fill in this information to identify the case:

United States Bankruptcy Court for the:

Southern District of New York (State)

Case number (*If known*): _____ Chapter 11

☐ Check if this is an amended filing

Official Form 201

Voluntary Petition for Non-Individuals Filing for Bankruptcy 06/22

If more space is needed, attach a separate sheet to this form. On the top of any additional pages, write the debtor's name and the case number (if known). For more information, a separate document, *Instructions for Bankruptcy Forms for Non-Individuals,* is available.

1. **Debtor's name** SVB Financial Group

2. **All other names debtor used in the last 8 years**
   Include any assumed names, trade names, and *doing business as* names
   N/A

3. **Debtor's federal Employer Identification Number** (EIN) 91-1962278

4. **Debtor's address**

Principal place of business

387 Park Avenue South
Number Street

New York NY 10016
City State ZIP Code

New York
County

Mailing address, if different from principal place of business

Number Street

P.O. Box

City State ZIP Code

Location of principal assets, if different from principal place of business

Number Street

City State ZIP Code

5. **Debtor's website** (URL)

Debtor SVB Financial Group Case number (*if known*)
Name

6. Type of debtor

- ☑ Corporation (including Limited Liability Company (LLC) and Limited Liability Partnership (LLP))
- ☐ Partnership (excluding LLP)
- ☐ Other. Specify: _____

7. Describe debtor's business

A. *Check one:*

- ☐ Health Care Business (as defined in 11 U.S.C. § 101(27A))
- ☐ Single Asset Real Estate (as defined in 11 U.S.C. § 101(51B))
- ☐ Railroad (as defined in 11 U.S.C. § 101(44))
- ☐ Stockbroker (as defined in 11 U.S.C. § 101(53A))
- ☐ Commodity Broker (as defined in 11 U.S.C. § 101(6))
- ☐ Clearing Bank (as defined in 11 U.S.C. § 781(3))
- ☑ None of the above

B. *Check all that apply:*

- ☐ Tax-exempt entity (as described in 26 U.S.C. § 501)
- ☐ Investment company, including hedge fund or pooled investment vehicle (as defined in 15 U.S.C. § 80a-3)
- ☑ Investment advisor (as defined in 15 U.S.C. § 80b-2(a)(11))

C. NAICS (North American Industry Classification System) 4-digit code that best descr bes debtor. See http://www.uscourts.gov/four-digit-national-association-naics-codes .

5 2 3 9

8. Under which chapter of the Bankruptcy Code is the debtor filing?

A debtor who is a "small business debtor" must check the first sub-box. A debtor as defined in § 1182(1) who elects to proceed under subchapter V of chapter 11 (whether or not the debtor is a "small business debtor") must check the second sub-box.

Check one:

- ☐ Chapter 7
- ☐ Chapter 9
- ☑ Chapter 11. *Check **all** that apply*:
  - ☐ The debtor is a small business debtor as defined in 11 U.S.C. § 101(51D), and its aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than $3,024,725. If this sub-box is selected, attach the most recent balance sheet, statement of operations, cash-flow statement, and federal income tax return or if any of these documents do not exist, follow the procedure in 11 U.S.C. § 1116(1)(B).
  - ☐ The debtor is a debtor as defined in 11 U.S.C. § 1182(1), its aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than $7,500,000, **and it chooses to proceed under Subchapter V of Chapter 11.** If this sub-box is selected, attach the most recent balance sheet, statement of operations, cash-flow statement, and federal income tax return, or if any of these documents do not exist, follow the procedure in 11 U.S.C. § 1116(1)(B).
  - ☐ A plan is being filed with this petition.
  - ☐ Acceptances of the plan were solicited prepetition from one or more classes of creditors, in accordance with 11 U.S.C. § 1126(b).
  - ☑ The debtor is required to file periodic reports (for example, 10K and 10Q) with the Securities and Exchange Commission according to § 13 or 15(d) of the Securities Exchange Act of 1934. File the *Attachment to Voluntary Petition for Non-Individuals Filing for Bankruptcy under Chapter 11* (Official Form 201A) with this form.
  - ☐ The debtor is a shell company as defined in the Securities Exchange Act of 1934 Rule 12b-2.
- ☐ Chapter 12

Debtor SVB Financial Group (Name) Case number (if known) _____

9. Were prior bankruptcy cases filed by or against the debtor within the last 8 years?

If more than 2 cases, attach a separate list.

☑ No

☐ Yes. District _____ When _____ (MM / DD / YYYY) Case number _____

District _____ When _____ (MM / DD / YYYY) Case number _____

10. Are any bankruptcy cases pending or being filed by a business partner or an affiliate of the debtor?

List all cases. If more than 1, attach a separate list.

☑ No

☐ Yes. Debtor _____ Relationship _____

District _____ When _____ (MM / DD / YYYY)

Case number, if known _____

11. Why is the case filed in *this district*?

Check all that apply:

☑ Debtor has had its domicile, principal place of business, or principal assets in this district for 180 days immediately preceding the date of this petition or for a longer part of such 180 days than in any other district.

☐ A bankruptcy case concerning debtor's affiliate, general partner, or partnership is pending in this district.

12. Does the debtor own or have possession of any real property or personal property that needs immediate attention?

☑ No

☐ Yes. Answer below for each property that needs immediate attention. Attach additional sheets if needed.

Why does the property need immediate attention? (*Check all that apply.*)

☐ It poses or is alleged to pose a threat of imminent and identifiable hazard to public health or safety.

What is the hazard? _____

☐ It needs to be physically secured or protected from the weather.

☐ It includes perishable goods or assets that could quickly deteriorate or lose value without attention (for example, livestock, seasonal goods, meat, dairy, produce, or securities-related assets or other options).

☐ Other _____

Where is the property? _____ (Number Street)

_____

_____ (City) _____ _____ (State ZIP Code)

Is the property insured?

☐ No

☐ Yes. Insurance agency _____

Contact name _____

Phone _____

Statistical and administrative information

Debtor SVB Financial Group (Name) Case number (if known)

13. Debtor's estimation of available funds	*Check one:* ☑ Funds will be available for distribution to unsecured creditors. ☐ After any administrative expenses are paid, no funds will be available for distribution to unsecured creditors.		
14. Estimated number of creditors	☐ 1-49 ☐ 50-99 ☐ 100-199 ☐ 200-999	☑ 1,000-5,000 ☐ 5,001-10,000 ☐ 10,001-25,000	☐ 25,001-50,000 ☐ 50,001-100,000 ☐ More than 100,000
15. Estimated assets	☐ $0-$50,000 ☐ $50,001-$100,000 ☐ $100,001-$500,000 ☐ $500,001-$1 million	☐ $1,000,001-$10 million ☐ $10,000,001-$50 million ☐ $50,000,001-$100 million ☐ $100,000,001-$500 million	☐ $500,000,001-$1 billion ☑ $1,000,000,001-$10 billion ☐ $10,000,000,001-$50 billion ☐ More than $50 billion
16. Estimated liabilities	☐ $0-$50,000 ☐ $50,001-$100,000 ☐ $100,001-$500,000 ☐ $500,001-$1 million	☐ $1,000,001-$10 million ☐ $10,000,001-$50 million ☐ $50,000,001-$100 million ☐ $100,000,001-$500 million	☐ $500,000,001-$1 billion ☑ $1,000,000,001-$10 billion ☐ $10,000,000,001-$50 billion ☐ More than $50 billion

Request for Relief, Declaration, and Signatures

WARNING -- Bankruptcy fraud is a serious crime. Making a false statement in connection with a bankruptcy case can result in fines up to $500,000 or imprisonment for up to 20 years, or both. 18 U.S.C. §§ 152, 1341, 1519, and 3571.

17. Declaration and signature of authorized representative of debtor

The debtor requests relief in accordance with the chapter of title 11, United States Code, specified in this petition.

I have been authorized to file this petition on behalf of the debtor.

I have examined the information in this petition and have a reasonable belief that the information is true and correct.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on 03/17/2023
MM / DD / YYYY

✘ /s/ William Kosturos
Signature of authorized representative of debtor

William Kosturos
Printed name

Title Chief Restructuring Officer

Debtor SVB Financial Group
Name

Case number (*if known*)

18. Signature of attorney

✘ /s/ James L. Bromley
Signature of attorney for debtor

Date 03/17/2023
MM / DD / YYYY

James L. Bromley
Printed name

Sullivan & Cromwell LLP
Firm name

125 Broad Street
Number Street

New York NY 10003
City State ZIP Code

(212)558-4000
Contact phone

bromleyj@sullcrom.com
Email address

2333912 NY
Bar number State

Official Form 201A (12/15)

[If debtor is required to file periodic reports (e.g., forms 10K and 10Q) with the Securities and Exchange Commission pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 and is requesting relief under chapter 11 of the Bankruptcy Code, this Exhibit "A" shall be completed and attached to the petition.]

[Caption as in Form 416B]

Attachment to Voluntary Petition for Non-Individuals Filing for Bankruptcy under Chapter 11

1. If any of the debtor's securities are registered under Section 12 of the Securities Exchange Act of 1934, the SEC file number is 001-39154.

2. The following financial data is the latest available information and refers to the debtor's condition on December 31, 2022.

a. Total assets $ 19,679,000,000[1]

b. Total debts (including debts listed in 2.c., below) $ 3,675,000,000

c. Debt securities held by more than 500 holders[2]

				Approximate number of holders:
secured ☐	unsecured ☒	subordinated ☐	$ 350,000[3]	Not available
secured ☐	unsecured ☒	subordinated ☐	$ 650,000[4]	Not available
secured ☐	unsecured ☒	subordinated ☐	$ 500,000[5]	Not available
secured ☐	unsecured ☒	subordinated ☐	$ 350,000[6]	Not available
secured ☐	unsecured ☒	subordinated ☐	$ 500,000[7]	Not available
secured ☐	unsecured ☒	subordinated ☐	$ 500,000[8]	Not available
secured ☐	unsecured ☒	subordinated ☐	$ 450,000[9]	Not available

d. Number of shares of preferred stock 383,500
e. Number of shares common stock 59,171,883

Comments, if any:

3. Brief Description of debtor's business: SVB Financial Group is a financial services company focusing on the innovation economy, offering financial products and services to clients across the United States and in key international markets. Prior to March 10, 2023, SVB Financial Group owned and operated Silicon Valley Bank, a state-chartered bank.

[1] As of December 31, 2022, approximately $15,456,000 was attributable to the debtor's bank subsidiary, Silicon Valley Bank.
[2] The debtor believes that its public debt may be widely held; however, the debtor is unable to determine with certainty the number of beneficial holders for each issuance of debt securities. Out of abundance of caution, each of the debtor's public debt issuances is detailed herein.
[3] 3.50% Senior Notes due 2025.
[4] 1.800% Senior Notes due 2026.
[5] 2.100% Senior Notes due 2028.
[6] 4.345% Senior Fixed Rate/Floating Rate Notes due 2028.
[7] 3.125% Senior Notes due 2030.
[8] 1.800% Senior Notes due 2031.
[9] 4.570% Senior Fixed Rate/Floating Rate Notes due 2033.

4. List the names of any person who directly or indirectly owns, controls, or holds, with power to vote, 5% or more of the voting securities of debtor:

The Vanguard Group
BlackRock, Inc.
State Street Corporation

SVB FINANCIAL GROUP

CHIEF RESTRUCTURING OFFICER'S CERTIFICATE
March 16, 2023

I, William Kosturos, hereby certify that I am the duly appointed and qualified Chief Restructuring Officer of SVB Financial Group, a Delaware corporation (the "Company"). I hereby further certify that the resolutions as attached as Exhibit A were duly adopted at a meeting of the Board of Directors of the Company, which meeting was held on March 16, 2023 and that as of such date hereof, the resolutions as attached as Exhibit A are in full force and effect.

IN WITNESS HEREOF, I, the undersigned Chief Restructuring Officer, have hereunto subscribed my name.

William Kosturos
Chief Restructuring Officer

EXHIBIT A

PROPOSED RESOLUTIONS TO BE ADOPTED BY
THE BOARD OF DIRECTORS OF
SVB FINANCIAL GROUP
March 16, 2023

VOLUNTARY PETITION AND BANKRUPTCY CASE

WHEREAS, the Board of Directors (the "***Board***") of SVB Financial Group, a corporation organized and existing under the laws of the State of Delaware (the "***Company***") has reviewed and discussed the financial and operational condition of the Company and the Company's business, including the current and historical performance of the Company, the assets and liquidity of the Company, the current and long-term liabilities of the Company and the market conditions;

WHEREAS, the Board has received, reviewed, and discussed the recommendations of management of the Company and the Company's legal, financial, and other advisors as to the relative risks and benefits of the strategic alternatives available to the Company, including a bankruptcy proceeding (the "***Bankruptcy Case***") under the provisions of Chapter 11 of Title 11 of the United States Code, 11 U.S.C. §§ 101 et seq. (the "***Bankruptcy Code***"), and has discussed the "first day" and certain subsequent filings that would be proposed to be made by the Company in connection with the Bankruptcy Case (the "***Initial Filings***");

WHEREAS, after review and discussion and due consideration of all of the information presented to the Board, the Board deems it advisable and in the best interests of the Company, its shareholders, its creditors, its subsidiaries, stakeholders, and other interested parties, for the Company to commence the Bankruptcy Case by filing a voluntary petition for relief under the provisions of the Bankruptcy Code (the "***Petition***"); and

WHEREAS, the Board deems it advisable and in the best interests of the Company, its shareholders, its creditors, its subsidiaries, stakeholders, and other interested parties, for the Company to make the Initial Filings and to conduct the business of the Company as contemplated thereby;

NOW, THEREFORE, IT IS HEREBY:

Filing of Voluntary Petition

RESOLVED, that having considered all relevant facts and circumstances, in the judgment of the Board, it is desirable and in the best interests of the Company, its shareholders, its creditors, its subsidiaries, stakeholders, and other interested parties that the Petition and the Initial Filings be filed by the Company in the United States Bankruptcy Court for the Southern District of New York (the "***Bankruptcy Court***"); and

RESOLVED, that the Company shall be, and it hereby is, authorized, directed and empowered (i) to file the Petition and the Initial Filings and (ii) to perform any and all such acts as are reasonable, advisable, expedient, convenient, proper or necessary to effect the foregoing; and

RESOLVED, that the Chief Restructuring Officer be, and hereby is, authorized, directed and empowered, on behalf of and in the name of the Company to execute and verify the Petition and the Initial Filings as well as all other ancillary documents and to cause the Petition and the Initial Filings to be

filed with the Bankruptcy Court, and to make or cause to be made prior to the execution thereof any modifications to the Petition, the Initial Filings, or any ancillary documents, and to execute, verify and file or cause to be filed all petitions, schedules, lists, motions, applications and other papers or documents, agreements, deeds, letters, instruments or certificates necessary or desirable in connection with any of the foregoing; and

RESOLVED, that the law firm of Sullivan & Cromwell LLP ("***S&C***") be, and hereby is, authorized, empowered and directed to represent the Company as its general bankruptcy counsel in connection with the Bankruptcy Case, to represent and assist the Company in carrying out its duties under the Bankruptcy Code and to take any and all actions to advance the Company's rights, including the preparation of pleadings and filings in the Bankruptcy Case; and in connection therewith, the Chief Restructuring Officer be, and hereby is, authorized, directed and empowered, on behalf of and in the name of the Company to execute appropriate retention agreements, pay appropriate retainers prior to and immediately upon the filing of the Bankruptcy Case, and to cause to be filed an appropriate application for authority to retain the services of S&C; and

RESOLVED, that the investment bank of Centerview Partners LLC ("***Centerview***") be, and hereby is, engaged to provide investment banking and other related services to the Company in the Bankruptcy Case; and in connection therewith, the Chief Restructuring Officer be, and hereby is, authorized, directed and empowered, on behalf of and in the name of the Company to execute appropriate retention agreements, pay appropriate retainers prior to and immediately upon the filing of the Bankruptcy Case, and to cause to be filed an appropriate application for authority to retain the services of Centerview; and

RESOLVED, that the firm of Alvarez & Marsal North America LLC ("***A&M***") be, and hereby is, engaged to provide restructuring advice and other related services to the Company in the Bankruptcy Case; and in connection therewith, the Chief Restructuring Officer be, and hereby is, authorized, directed and empowered, on behalf of and in the name of the Company, to execute appropriate retention agreements, pay appropriate retainers prior to and immediately upon the filing of the Bankruptcy Case, and to cause to be filed an appropriate application for authority to retain the services of A&M; and

RESOLVED, that the firm of Kroll Restructuring Administration LLC ("***Kroll***") be, and hereby is, engaged to act as notice, claims and balloting agent and to provide other related services to the Company in the Bankruptcy Case; and in connection therewith, the Chief Restructuring Officer be, and hereby is, authorized, directed and empowered, on behalf of and in the name of the Company, to execute appropriate retention agreements, pay appropriate retainers prior to and immediately upon the filing of the Bankruptcy Case, and to cause to be filed an appropriate application for authority to retain the services of Kroll; and

RESOLVED, that, the Chief Restructuring Officer be, and hereby is, authorized to cause the Company to employ other special counsel, financial advisors, investment bankers, accountants, restructuring advisors, notice, balloting and claims agents and other professionals as appropriate in connection with the Bankruptcy Case and all related matters.

General Authority and Implementing Resolutions

RESOLVED, that the necessity, advisability and appropriateness of any action taken, any approval given or any amendment or change to any document or agreement made by the Chief Restructuring Officer pursuant to the authority granted under these resolutions shall be conclusively evidenced by the taking of any such action, or the execution, delivery or filing of any such document or agreement;

RESOLVED, that the Board hereby adopts and incorporates by reference any form of specific resolution not inconsistent with these resolutions to carry into effect the purpose and intent of the foregoing resolutions, or covering authority including in matters authorized in the foregoing resolutions, including forms of resolutions in connection therewith that may be required by a trustee, the SEC, the Federal Deposit Insurance Corporation, the Federal Reserve, the California Department of Financial Protection and Innovation, the NASDAQ, the Financial Industry Regulatory Authority or any state or other institutions, person, agency or governmental authority (collectively, "***Governmental Entities***"), and the Secretary of the Company is hereby directed to insert a copy thereof in the minute book of the Company following the minutes of this meeting and certify the same as duly adopted thereby;

RESOLVED, that the Chief Restructuring Officer is hereby authorized and empowered to perform, or cause to be performed, all such acts, deeds and things to make, execute and deliver, or cause to be made, executed and delivered, all such agreements, undertakings, documents, instruments or certificates in the name and on behalf of the Company or otherwise as the Chief Restructuring Officer may deem necessary, advisable or appropriate to effectuate or carry out fully the purpose and intent of the foregoing resolutions, including with respect to any filings, submissions or notices that may be required by any Governmental Entities with respect to the matters addressed herein; and

RESOLVED, that all acts and deeds heretofore done in connection with the actions contemplated in the above resolutions by any officer or director of the Company for or on behalf of the Company in entering into, executing, acknowledging or attesting any arrangements, agreements, instruments or documents, or in carrying out the terms and intentions of the above resolutions are hereby ratified, approved and confirmed in all respects.

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